Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1994

GENERAL ENVIRONMENTAL SCIENCE CORP.,

Petitioner,

vs.

FRANK L. HORSFALL, BIOSYS CORPORATION, GUSTAVO GYSLER, STEPHEN WALTERS, JASON C. BLACKFORD, THOMAS C. BUFORD,

Respondents.

Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit

PETITION FOR A WRIT OF CERTIORARI

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184 pp

QUESTIONS PRESENTED

I. WHETHER A COURT OF APPEALS MAY VACATE A DEFAULT JUDGMENT IMPOSED BY A DISTRICT COURT AS A DISCOVERY SANCTION PURSUANT TO FEDERAL RULE OF CIVIL PROCEDURE 37 BY APPLYING THE STANDARD OF REVIEW APPLICABLE TO RULE 55 DEFAULT JUDGMENTS, RATHER THAN THE RULE 37 STANDARD SET FORTH IN THIS COURT'S DECISION IN *NATIONAL HOCKEY LEAGUE V. METROPOLITAN HOCKEY CLUB, INC.*, 427 U.S. 639 (1976), WHICH REQUIRES THAT DEFERENCE BE AFFORDED THE DISTRICT COURT'S JUDGMENT ON SANCTIONS.

II. WHETHER, IN CONTRAVENTION OF THIS COURT'S DECISION IN *CHAMBERS V. NASCO, INC.*, 501 U.S. 32 (1991), A COURT OF APPEALS MAY VACATE AN AWARD OF ATTORNEY FEES ENTERED BY A DISTRICT COURT PURSUANT TO ITS INHERENT POWER ON THE GROUND THAT ALL ASPECTS OF THE AWARD ARE NOT DIRECTLY RELATED TO A VIOLATION OF FEDERAL RULE OF CIVIL PROCEDURE 37.

III. WHETHER A DISTRICT COURT WHICH HAS AWARDED ATTORNEY FEES AND COSTS AGAINST COUNSEL PURSUANT TO FEDERAL RULE OF CIVIL PROCEDURE 37 BASED ON DETAILED FACTUAL FINDINGS THAT COUNSELS' CONDUCT WAS "EGREGIOUS AND SANCTIONABLE", MAY VACATE SUCH AN AWARD, WITHOUT FINDING, AS REQUIRED BY THE TEXT OF RULE 37, THAT COUNSELS' CONDUCT WAS "SUBSTANTIALLY JUSTIFIED" OR THAT AN AWARD OF SANCTIONS WOULD BE "UNJUST".

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No. _____

In The

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GENERAL ENVIRONMENTAL SCIENCE CORP.,[1]

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vs.

FRANK L. HORSFALL, BIOSYS CORPORATION, GUSTAVO GYSLER, STEPHEN WALTERS, JASON C. BLACKFORD, THOMAS C. BUFORD,

Respondents.

Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit

PETITION FOR A WRIT OF CERTIORARI

Petitioner, General Environmental Science Corp. (hereinafter "GES") prays that a writ of certiorari issue to review a judgment of the U.S. Court of Appeals for the Sixth Circuit, vacating a default judgment entered by the district court after several hearings and after entering detailed findings pursuant to Federal Rule of Civil Procedure 37. Review is appropriate pursuant to Rule 10 of the Rules of this Court because the decision of the Sixth Circuit conflicts with decisions of several other courts of appeals and with decisions of this Court in regard to the standards of appellate review applicable to default judgments entered pursuant to Federal Rule of Civil Procedure 37, awards of attorney fees pursuant to the

[1] General Environmental Science Corp. has no parent or subsidiary companies.

district court's inherent powers, and to recusal of district judges. *See* Rule 10.1.(a).

OPINIONS BELOW

The unpublished opinion of the United States Court of Appeals for the Sixth Circuit is attached as part of the Appendix, App. 1-38. The opinions of the Honorable Frank J. Battisti of the United States District Court for the Northern District of Ohio, Eastern Division, are attached as part of the Appendix, App. 39-145.

STATEMENT OF JURISDICTION

The judgment of the United States Court of Appeals for the Sixth Circuit was entered on May 25, 1994. Petitioner's petition for rehearing and rehearing *en banc* pursuant to Rules 35 and 40 of the Federal Rules of Appellate Procedure was denied on July 11, 1994. (App. 146-147). The jurisdiction of this Court is invoked pursuant to 28 U.S.C. Section 1254(1).

STATUTES AND RULES INVOLVED

Federal Rule of Civil Procedure 37(b)(2)(C) provides:

> If a party or an officer, director, or managing agent of a party or a person designated under Rule 30(b)(6) or 31(a) to testify on behalf of a party fails to obey an order to provide or permit discovery, including an order made under subdivision (a) of this rule or Rule 35, or if a party fails to obey an order entered under Rule 26(f), the court in which the action is pending may make such orders in regard to the failure as are just, and among others the following:
>
> * * *
>
> (C) An order striking out pleadings or parts thereof, or staying further proceedings until the order is obeyed, or dismissing the action or proceeding or any part thereof, or rendering a judgment by default against the disobedient party. . . .

> In lieu of any of the foregoing orders or in addition thereto, the court shall require the party failing to obey the order or the attorney advising that party or both to pay the reasonable expenses, including attorney's fees, caused by the failure, unless the court finds that the failure was substantially justified or that other circumstances make an award of expenses unjust.

28 U.S.C. § 455(a) provides:

> Any justice, judge or magistrate of the United States shall disqualify himself in any proceeding in which his impartiality might reasonably be questioned.

STATEMENT OF THE CASE

GES, headquartered in Cleveland, Ohio, is engaged in the manufacture and worldwide sale of microbiological products used in waste water treatment. Prior to May 19, 1989, Frank L. Horsfall was Vice-President of Research and Development for GES. After that date, Horsfall served as a consultant for GES, until November 1989 when he was employed by a Swiss corporation, X-O Corporation. At about that same time, John L. Strauss, a GES sales representative, also became an owner and employee of X-O Corporation. X-O Corporation was headed by Strauss's brother-in-law, Gustavo Gysler, and had been a dormant corporation before its revival by Gysler in May 1989 to act as a distributor of aquarium products for GES. In November 1989, Strauss, Horsfall, and Gysler induced GES to enter into a license agreement whereby X-O (later renamed "Biosys") became GES's exclusive distributor in Europe. The license agreement was part of a conspiracy by Horsfall, Strauss and Gysler to steal and use GES trade secrets to compete with GES in Europe. In furtherance of the conspiracy, they solicited GES customers, formed corporate entities to disguise their competition, and prepared facilities for use in competing with GES.

GES learned of the conspiracy as a result of Biosys entering into unauthorized contracts with GES customers and attempting to solicit such customers to join the conspiracy. Horsfall and Strauss told GES customer Karl Ehrlich, of

Aquaresearch, Quebec, Canada, that "the major goal of the scheme proposed . . . was to license [GES] technology to various users throughout the world. . . . " Strauss told Ehrlich that respondents planned to enter into

> a contract for distribution with GES that they never intended to honor, and that they planned in the future to break this contract as soon as they could set up their own protection facilities and that they would use product variability and potency as a basis for breaking the contract and competing [with GES]. (App. 5 n. 4, 73-74).

On May 4, 1990, when GES notified Gysler that GES was aware of the scheme, Gysler ceased doing business as Biosys and "formed Biosphere, S.A., a company that was in many respects, indistinguishable from Biosys." (App. 4). " . . . Biosys and Biosphere shared the same directors, managers, employees, business purposes, and telephone and facsimile facilities. Moreover, the companies even sold products under substantially identical names." (*Id.*). Gysler, Horsfall and Strauss were the principal owners, officers and employees of both Biosys and Biosphere, and have continued to compete with GES in Europe under the name Biosphere.

On July 27, 1990, GES filed a complaint against Horsfall, Strauss, Gysler, and Biosys, alleging theft of trade secrets, and state tort and contract claims, among others. The district court ordered expedited discovery to be completed by September 30, 1990, with a hearing on GES's motion for preliminary injunction to be held on October 29, 1990. Defendants were represented by one law firm and presented a joint defense.[2]

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[2] All parties to this case are reflected in the caption with the exception of John Strauss, whose appeal was stayed because of his filing for bankruptcy. The district court in several orders imposed discovery sanctions on both the defendants and their counsel. Horsfall, Biosys, Gysler, and Strauss are referred to herein as "defendants", and Blackford, Buford, and Walters are referred to as "defense counsel". Horsfall, Gysler, Biosys,

During the course of discovery, defendants and/or their counsel thwarted discovery and evaded any resolution of the case on its merits by failing to respond to document requests and interrogatories; by refusing to answer deposition questions; by filing various frivolous motions; and by procuring the destruction of documents which the district court found rendered the case untriable. The district court dealt with defendants' conduct with patience by granting defendants the opportunity to explain their position at hearings, by warning defendants before sanctions were imposed, and by making detailed factual findings supporting the sanctions eventually imposed.

Initially, respondents invoked the Swiss blocking statute to avoid answering interrogatories and deposition questions. On September 14, 1990, the district court found that discovery was governed by American, not Swiss, procedures, and that defendants' argument, in light of their ownership of Biosys, was "nothing more than slight [sic] of hand." (App. 40).

Despite the district court's order, defendants and their counsel continued to refuse to provide discovery. On September 20, 1990, GES filed a motion to compel discovery and for an award of attorney fees.[3] Defendants and their counsel continued to insist that the depositions and document production must be in compliance with Swiss law. Defendants opposed the motion to compel on the ground that Biosphere (which now had all the documents and was the real party in interest) was protected by the Swiss blocking statute from producing the documents, and that defendants could not be required to produce the documents of Biosphere despite the fact that they owned the majority of its stock and were its principal employees. At a hearing on the motion to compel,

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Buford, Blackford, and Walters are collectively referred to as "respondents".

[3] As a result of respondents' obstruction of discovery, the district court rescheduled the hearing on GES's motion for preliminary injunction. Ultimately, the hearing was postponed indefinitely.

defense counsel told the district court that Biosys and Biosphere "are two separate companies that sort of fell out of the sky."

On April 4, 1991, the district court granted GES's motion to compel, finding that defendants, as majority owners and principal employees of Biosys and Biosphere, could not refuse to provide the discovery requested. (App. 70, 77, 78). The district court awarded GES attorney fees and costs associated with the motion and ordered defendants to provide the requested discovery within 20 days.

After 20 days had passed, no defendant had appeared for deposition, no documents had been produced, and no further interrogatory answers had been received. Defense counsel consistently refused to provide deposition dates, consistently promised documents which never appeared, and consistently promised compliance, which constantly failed. When defense counsel refused even to provide dates for defendants' depositions, GES noticed defendants' depositions. Neither defendants nor defense counsel appeared for the depositions.

In light of defendants' stubborn refusal to comply, GES filed a motion for default judgment and attorney fees. The district court, in a May 24 order, found that defendants had violated the April 4, 1991 order compelling discovery, and set new response dates for document production, interrogatory answers and depositions. (App. 87). "The defendants were warned that further intransigence on their part could lead to the imposition of ultimate sanctions." (*Id.*). The district court also awarded GES attorney fees associated with the motion and proceedings relating to it, and held that GES could renew its motion after the depositions. (App. 89, 90).

Defendants and their counsel immediately set about frustrating the discovery which had been scheduled by the district court. Despite the existence of a protective order permitting documents to be produced with access limited to attorneys only, defense counsel Walters filed, under seal and inaccessible to GES, what he described as a critical document (known as "A7077") which he claimed would prove that the products

of GES and Biosphere were different. Walters, in a post-judgment affidavit, admitted that, before he filed A7077 under seal, "I determined that we could not withhold Biosphere document A7077." Nevertheless, at the request of Gysler, Walters contrived the filing under seal to keep the document from GES.

The continued depositions were characterized by verbal attacks by defense counsel on GES counsel and the district court. Defense counsel Walters encouraged contempt by his clients toward the district court by referring to "unusual rulings." Walters threatened GES counsel that "the wrath of God will come down where it needs to come down," and made other personal attacks such as "Have you no decency?", "That is a boldfaced untruth, sir," "You are behaving like Roy Cohn," and "God, are we devious. I assure you most people in the United States don't conduct business that way."

Nevertheless, in the course of the depositions, GES learned that during the pendency of GES's September 20, 1990 motion to compel, defendants had destroyed documents requested by GES. As described by the district court:

> Defendants admit that predecessor documents to Document A7077 existed. The first such document was created in October 1990. . . . Six successor documents were created and additions, deletions and modifications were made to the 'working documents' from time to time. . . . These documents would purportedly trace the development of defendants' products from the date they terminated their contract with GES. . . . Horsfall admits destroying the predecessor documents to Document A7077. . . . According to Horsfall, the destruction continued from October 1990 to April or May 1991.

(App. 101, 102) (citations omitted). Horsfall also destroyed his working notes relating to product development and explained the absence of and failure to maintain such notes by testifying that "the formula for the new products simply sprang from his head." (App. 103).

In light of these discovery abuses, GES renewed its motion for default judgment against respondents. On the eve of the scheduled hearing on the motion, Walters released to GES the document (A7077) filed under seal, six months after he had withheld it. When GES reviewed A7077, the need for the predecessor documents became clear and the motion for sanctions was amended accordingly.

At hearing on the motion, Horsfall, confronted with his destruction of A7077's predecessors, testified that A7077 was meaningless and that, therefore, GES suffered no prejudice by his destruction of its predecessors. The district court found Horsfall's testimony to be "void of credibility". (App. 105). At the hearing, the district court questioned defense counsel about "whether the defendants' non-compliance was defendants' fault or his counsel's fault." Defense counsel's only response was that there was no evidence of misconduct by counsel.

After the hearing, fearing that the district court might grant default judgment, Horsfall returned to Switzerland and "found" some A7077 predecessors which he testified, both at deposition and in the sanctions hearing, had been destroyed. Other destroyed lab books were never found. (App. 116). On March 3, 1992, defense counsel moved to withdraw on the ground of nonpayment of fees, which motion was denied.

On March 10, 1992, the district court entered default judgment against defendants pursuant to Federal Rule of Civil Procedure 37, and awarded attorneys fees and costs associated with the case against defendants and defense counsel pursuant to both Rule 37 and its inherent power. (App. 92).

Applying the standards set forth in Federal Rule of Civil Procedure 37(b)(2)(C) and this Court's decision in *National Hockey League v. Metropolitan Hockey Club, Inc.*, 427 U.S. 639 (1976), the district court found:

> Defendants have repeatedly attempted to relitigate points of law decided against them. Defendants have continued to invoke Swiss law as a shield against discovery even though this position was rejected by the Court less than two months after the

> case was filed. Defendants have also attempted to relitigate the issue of confidentiality despite the Order of confidentiality contained in the April Order. Finally, Defendants repeatedly have objected to discovery on the grounds that Biosphere is not a party to this litigation despite the April Order finding that "Gysler, Strauss and Horsfall, in particular, as owners and employees of Biosphere, have no right to refuse to provide the information requested by Plaintiff."

(App. 109, 110.) The district court found that defendants were aware of plaintiff's document requests and the court's April 4, 1991 and May 24, 1991 orders, and that document A7077 and other documents relating to creation of the Biosphere products were within the scope of the requests. (App. 109, 110). The court found that defendants had destroyed discoverable documents.

The court found 1) that GES was prejudiced by the irretrievable loss of evidence and the expense and inconvenience involved in uncovering the document destruction scheme; 2) that the destroyed documents were the only primary scientific evidence tracing the development of the product line which defendants used to compete with GES; and 3) that GES should not be required to rely on the "highly questionable predecessors" produced by defendants at the last minute. (App. 111). The court found that defendants' withholding of document A7077 and destruction of its predecessors impeded completion of depositions and prejudiced GES. (App. 102).

The district court held that no lesser sanction was appropriate given the fact that the previous awards of attorney fees in the April 4 and May 24 orders had no effect on defendants' behavior. (App. 113). Citing the opinion of this Court in *National Hockey League v. Metropolitan Hockey Club, Inc.*, 427 U.S. 639 (1976) and Justice Kennedy's opinion in *G-K Properties v. Redevelopment Agency*, 577 F.2d 645 (9th Cir.

1978), the court held that lesser sanctions "would not compensate for the damage to the judicial process and the integrity of the result in this case occasioned by defendants' destruction of documents." (App. 114). The court also held that a party may not avoid sanctions by last-minute compliance under the "sporting chance theory" condemned by Justice Kennedy in *G-K Properties*. (App. 115). The district court was "at a loss as to how to remedy this matter short of default judgment." (App. 117).

The district court relied on its inherent power as authority for awarding attorney fees relating to the entire action against both defendants and their counsel. *Chambers v. NASCO, Inc.*, 501 U.S. 32 (1991). (App. 118-120). The district court's findings relative to defense counsel were extensive. (App. 120-122).

On April 21, 1992, after a continuance requested by defendants, the district court held a hearing on damages, attorney fees, and costs, at which all parties and defense counsel were represented and presented evidence. Based upon sworn testimony and affidavits, the district court found that GES had suffered $1,317,962.13 in actual damages, and awarded additional punitive and treble damages. (App. 124). The district court rendered defendants and defense counsel jointly and severally liable for $268,284.64 in attorney fees and costs, in addition to those awarded by virtue of the April 4, 1991 Order. (App. 144).

On June 8, 1992, seven months after the hearing on sanctions and three months after sanctions were imposed, defense counsel, through separate counsel, filed a motion to amend or alter the judgment and for a new trial pursuant to Federal Rule 59(e). The motion sought to relitigate the issue of sanctions determined by the March 10, 1992 Order through affidavits from defense counsel which could have been presented to the district court prior to judgment but which were not. Defense counsel sought to blame defendants, who had fled to Switzerland, for the obstruction of discovery.

On September 16, 1992, the district court entered a two-page order on defense counsels' post-trial motion. (App. 144). The district court reaffirmed its finding that the conduct of counsel was "egregious and sanctionable", but vacated that part of the judgment holding defense counsel liable for attorney fees and costs. All defendants and GES appealed.

On May 25, 1994, the court of appeals vacated the default judgment. The court of appeals did not find that the district court's findings were clearly erroneous, but held instead that it did not "feel" that the sanctions selected by the district court were appropriate. (App. 27). Despite acknowledging that Rule 37 was the basis for the judgment, the court of appeals applied the standard for vacating defaults under Federal Rule of Civil Procedure 55, finding that, in order to reverse, the court of appeals need not find "a 'glaring abuse' of discretion," (App. 20), and noting that the Sixth Circuit has been less reluctant than other circuits to vacate district court decisions imposing sanctions (App. 23). It did not find an abuse of discretion.

Without holding that any of the district court's findings were clearly erroneous or legal error, the court of appeals found that:

1) "Judge Battisti should not have treated defendants monolithically," despite the fact that they presented a joint defense until after judgment was rendered (App. 24 n. 13);
2) It was, "far from settled" whether Horsfall should have preserved, rather than destroy the documents requested by GES, despite the district court's finding that Horsfall's testimony was "void of credibility" (App. 25);
3) "Whether Gysler's action can be attributed to 'willfulness, bad faith, or fault' we feel is too close a question to justify a default judgment," despite the extensive findings of the district court to the contrary (App. 27) (emphasis added); and
4) "[T]he magnitude of Judge Battisti's damages award only compounds the inappropriateness of

his action," despite the fact that all defendants were represented and presented evidence on damages (*Id.*).

The court vacated the award of attorney fees because "we express skepticism as to whether the judge would have ordered this sanction without having entered a default judgment," despite the fact that the district court had twice awarded attorney fees in the case on April 4 and May 24, without entering default. (App. 28).

Although not disputing Judge Battisti's finding that defense counsels' conduct was "egregious and sanctionable", the court of appeals, like the district court, did not find, as required by Rule 37, that defense counsels' conduct was "substantially justified" or that an award of fees would be "unjust". Accordingly, the court of appeals denied GES's cross-appeal.

REASONS FOR GRANTING THE WRIT

I. THE DECISION OF THE SIXTH CIRCUIT CONFLICTS WITH THE DECISION OF THIS COURT IN *NATIONAL HOCKEY LEAGUE* AND WITH THE DECISIONS OF OTHER COURTS OF APPEALS REGARDING THE STANDARD OF REVIEW APPLICABLE TO DEFAULT JUDGMENTS ENTERED PURSUANT TO FEDERAL RULE 37.

In a series of cases, culminating in this case, the Court of Appeals for the Sixth Circuit has developed standards applicable to the review of district court judgments awarding discovery sanctions which differ from those applied by this Court and by other courts of appeals. One purpose of the Federal Rules of Civil Procedure is to promote uniformity and predictability in practice in the federal courts. The application of different interpretations of those rules in different judicial districts and circuits promotes contrary values of uncertainty and lack of confidence among litigants and lawyers in the system and the rules governing it.

The decision of the Sixth Circuit departs from the standard set forth by this Court in *National Hockey League* in several respects.

A. The Sixth Circuit Applied The Standard of Review for Default Judgments Entered Pursuant to Rule 55, Rather Than Rule 37, A Result Contrary to the Text of the Rules, the Opinions of this Court, and the Policies Underlying the Rules.

The Sixth Circuit has admitted that it is less reluctant than other circuits to vacate district court orders dismissing complaints or granting default judgments. *Regional Refuse Systems v. Inland Reclamation Co.*, 842 F.2d 150, 154-155 (6th Cir. 1988). "[T]his circuit had been less reluctant than others to reverse dismissals prompted by a party's failure to comply with discovery orders." (App. 23). By its own admission, this "reluctance" affected the court's review of the sanctions entered by the district court. (*Id.*) ("It is against this backdrop that we consider defendants' claim that Judge Battisti abused his discretion. . . . "). *See Wexell v. Komar Industries, Inc.*, 18 F.3d 916, 920 (Fed. Cir. 1994).

As the language of the opinion demonstrates, the Sixth Circuit has rationalized its "reluctance" to affirm district court awards of sanctions by bootstrapping the standards for vacating default judgments under Rule 55 into review of Rule 37 defaults. Use of the Rule 55 standard in Rule 37 cases is improper because the two rules serve different purposes and promote different values.

Rule 55 permits an entry of default when a party fails to "plead or otherwise defend." Rule 55(a).[4] Under Rule 55, a default judgment is most often entered against a party due to

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[4] Default judgment could not have been entered against defendants in this case pursuant to Rule 55(a) because defendants appeared and defended. Accordingly, since default could not have been granted pursuant to Rule 55, there is no basis for using Rule 55 standards in determining whether a Rule 37 default should be vacated.

neglect by the party or counsel, *i.e.* failure to file an answer, failure to appear for a hearing. Therefore, due to the less severe nature of the conduct, the courts have regularly considered factors such as the merits of the defaulting party's position, the harshness of the sanction, and the judicial preference to have matters heard on their merits in determining whether to vacate the Rule 55 default.

This Court in *National Hockey League* found none of these factors relevant in holding that the court of appeals improperly reversed the district court's dismissal, pursuant to Rule 37, of a multi-million dollar antitrust claim. Indeed, it was the harshness of the sanction of dismissal and its deterrent effect which required its application. In that case, the court of appeals had reversed the judgment of the district court which dismissed plaintiff's antitrust claims for failure to timely answer interrogatories. The court of appeals "did not question any of the findings of fact which had been made by the District Court," but, nevertheless, reversed. (*Id.* at 641). This Court found that "the comprehensive memorandum of the District Court supporting its order of dismissal indicates that it considered the full record" and that "the District Court was extremely patient in its efforts to allow the respondents ample time to comply with its discovery orders." *Id.* at 642.[5] This Court articulated the standard of review for Rule 37 sanctions.

> The question, of course, is not whether this Court, or whether the Court of Appeals, would as an original matter have dismissed the action; it is whether the District Court abused its discretion in so doing.

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[5] The district court's lengthy and detailed opinions in this case indicate the same full consideration of the record and patience with defendants, despite the fact that the conduct was much more egregious than the failure to answer interrogatories which was at issue in *National Hockey League*. *See Insurance Corp. of Ireland*, 456 U.S. at 707 ("Because the District Court's decision to invoke the sanction was accompanied by a detailed explanation of the reasons for that order. . . . this issue need not detain us long.").

Id. at 642. *See Insurance Corp. of Ireland v. Compagnie des Bauxites*, 456 U.S. 694, 705-707 (1982).

In *National Hockey League*, 427 U.S. 639, this Court recognized that the purpose of Rule 37 sanctions, like most sanctions, is to deter future misconduct, not merely to punish the party who is the direct object of the sanction. *The Court also warned the court of appeals not to be unduly influenced by the severity of the sanction.*

> There is a natural tendency on the part of reviewing courts, properly employing the benefit of hindsight, to be heavily influenced by the severity of outright dismissal as a sanction for failure to comply with a discovery order. It is quite reasonable to conclude that a party who has been subjected to such an order will feel duly chastened, so that even though he succeeds in having the order reversed on appeal he will nonetheless comply promptly with future discovery orders of the District Court.
>
> But here, as in other areas of the law, the most severe in the spectrum of sanctions provided by the statute or rule must be available to the District Court in appropriate cases, not merely to penalize those whose conduct may be deemed to warrant such a sanction, but to deter those who might be tempted to such conduct in the absence of such a deterrent. If the decision of the Court of Appeals remained undisturbed in this case, it might well be that *these* respondents would faithfully comply with all future discovery orders entered by the District Court in this case. But other parties to other lawsuits would feel freer than we think Rule 37 contemplates they should feel to flout other discovery orders of other District Courts.

Id. at 642-643. The Court has subsequently reiterated these principles. *See Roadway Express, Inc. v. Piper*, 447 U.S. 752, 763 (1980).

Other courts of appeals have applied the Rule 37 standard articulated in *National Hockey League* rather than the Rule 55 standard in reviewing Rule 37 sanctions. *See Adriana Int'l*

Corp. v. Thoeren, 913 F.2d 1406, 1411 (9th Cir. 1990); *Weisberg v. Webster*, 749 F.2 664, 869 (D.C. Cir. 1984) ("our task is limited by the proper scope of appellate review."). As the Seventh Circuit has stated:

> We cannot understate [sic] the difficulty of the task litigants face when challenging a district court's choice of sanctions. They must convince us that the district court abused its discretion in sanctioning them – a burden which is met only when it is clear that no reasonable person would agree with the trial court's assessment of what sanctions are appropriate . . . . Most are unable to meet so demanding a standard.

Marroco v. General Motors, 966 F.2d 220, 223 (7th Cir. 1992) (default judgment affirmed).

In *Jankins v. TDC Management Corp.*, 21 F.3d 436 (D.C. Cir. 1994), the D.C. Circuit affirmed the judgment of the district court precluding defendants from introducing evidence or contesting certain claims and counterclaims and awarded attorney fees of $70,699 where the defendants had withheld financial records and computer disks from discovery. As in this case, defendants' misconduct caused extensions of the discovery and trial dates. *Id.* at 444. The court of appeals rejected defendants' plea that the sanctions were too harsh. "The sanctions were 'harsh' simply because harshness was 'warranted.' " *Id.* at 445. Recognizing that its review was limited to abuse of discretion, the court of appeals found no abuse "[g]iven the defendants' willful misconduct, and the purpose of sanctions as a penalty and to deter misconduct by others." *Id.*

The Sixth Circuit's application of the Rule 55 standard in this case is evidenced by its reliance on its opinion in *United Coin Meter Co. v. Seaboard Coastline Railroad*, 705 F.2d 839 (6th Cir. 1983), a Rule 55 case. In setting forth the law, the court stated that "[o]ur analysis of the issue is further informed by the harsh nature of the sanction in dispute as well as our well-established preference for trials on the merits." (App. 23). More significantly, the court of appeals, contrary

to Rule 37 and *National Hockey League*, held that "a 'glaring abuse' of discretion is not required for reversal of a court's refusal to relieve a party of the harsh sanction of default." (App. 23). The Court expressed this same inclination later in its opinion, citing *United Coin* for the proposition that "[a]ny doubt should be resolved in favor of the petition to set aside the judgment so that cases may be decided on their merits. Since the interests of justice are best served by a trial on the merits, only after a careful study of all relevant considerations should courts refuse to open default judgment." (App. 27).

A quick reference to the facts of *United Coin Meter* demonstrates the difference between Rule 37 and Rule 55 defaults. In *United Coin Meter*, counsel for the parties agreed that defendant could have an extension of time of 20 days to answer the complaint. When the 20 days passed, plaintiff's counsel moved for default under Rule 55, which was granted. On postjudgment motion and appeal, it was determined that "the only matter in dispute between the parties is the time from which the 20 days was to run." *Id.* at 841.

The *United Coin Meter* case and this case are eons apart, and demonstrate the differences between Rule 55 and Rule 37. The rules are targeted at different behavior. A Rule 55 default is easy to obtain (late answer), and, therefore, is easier to vacate. A Rule 37 default is difficult to obtain, and requires a finding of bad-faith behavior which can be dealt with in no manner other than by default. Accordingly, a more deferential standard of review applies to Rule 37 defaults, and such judgments, per *National Hockey League*, are more difficult to vacate.

Judges of the Court of Appeals for the Sixth Circuit themselves have recognized the circuit's divergence from the standards of *National Hockey League* as applied by other courts of appeals. At about the same time as its decision in this case, the Sixth Circuit reversed a district court's dismissal of a complaint due to the plaintiff's violation of a protective order. *Coleman v. American Red Cross*, 23 F.3d

1091 (6th Cir. 1994). Judge Ryan dissented, stating that the court failed to give appropriate deference to the decision of the district court, and that the issue on appeal ought to be "whether dismissal was within the range of sanction options available to the district court." *Id.* at 1098. Judge Ryan recognized that "whatever the 'reluctance' of a panel of this and other courts to uphold dismissal as a sanction for violation of a court's order, the Supreme Court has decided unequivocally that dismissal is a proper sanction. . . . " *Id.* at 1100. Judge Ryan summed up:

> There is a compelling, indeed binding legal authority, . . . to say nothing of judicial common sense, to support the conclusion that dismissal of the plaintiff's case was within the range of options available to the district court for dealing with counsel's misconduct. It may be that the judges of this panel would have elected a different sanction, one directed exclusively at counsel. But we are not empowered to second-guess the district court's discretion. We owe the district court deference to its discretionary call unless we are able to conclude that it had no authority to act as it did; that, as a matter of law, dismissal was not an option available to the court. This the court cannot do since, plainly, the law is to the contrary.

Id. at 1101.

In this case, the Sixth Circuit, by reference to *United Coin*, operated on the presumption that the default judgment was to be vacated, rather than on the contrary presumption dictated by *National Hockey League* that the district court's exercise of discretion is to be respected and affirmed. Nothing in the text of Rule 37 or the decisions of this Court or the other courts of appeals supports either the Sixth Circuit's "reluctance" to impose discovery sanctions or application of the Rule 55 standard to Rule 37 judgments. Accordingly, the writ should issue to correct this case, to correct this split

among the circuits and provide for uniformity and predictability in the application of sanctions for violation of the discovery rules.[5]

B. The Court of Appeals Failed to Apply the Clear Error Standard to the District Court's Findings of Fact.

The Court of Appeals in this case never cited or applied the clear error standard. Other courts of appeals have adhered to this standard in reviewing the district court's findings of fact, pursuant to *Anderson v. Bessemer City,* 470 U.S. 564 (1985), refusing to vacate factual findings unless clearly erroneous. *See Stookey v. Teller Training Distributors,* 9 F.3d 631 (7th Cir. 1993). "If the district court's account of the evidence is plausible in light of the record viewed in its entirety, the Court of Appeals may not reverse it even though convinced that had it been sitting as the trier of fact, it would have weighed the evidence differently. Where there are two permissible views of the evidence, the fact finder's choice between the two of them cannot be clearly erroneous." *Anderson,* 470 U.S. at 574.

The Sixth Circuit never suggested that the conduct of defendants and their counsel was not sufficiently egregious to be sanctionable. (App. 23) ("We pass no judgment on whether

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[5] Further, there is no textual basis in Rule 37 for altering the standard of review based on the dollar values involved. The Court of Appeals found that the $12 million judgment entered by the district court was "an excessively harsh, even draconian penalty." (App. 24). Other courts have not measured the appropriateness of the district court's sanction by the dollars involved, regardless of whether the sanction applied was default or dismissal. *See Insurance Corp. of Ireland,* 456 U.S. at 697 (losses in excess of $10 million); *Regional Refuse Systems, supra,* (complaint alleged losses of hundreds of millions). The Court of Appeals ignored the fact that there had been a trial on damages, that respondents had offered evidence, and that the district court had made detailed findings on the issue of damages. Parties may not use the size of the damages proven as evidence of the impropriety of the default when they had an opportunity for full trial on damages.

some sanctions may have been in order. . . . "); *Id.* at 24 ("we do not mean to approve of any of the machinations undertaken to this point in the proceedings."). Nevertheless, the court of appeals sought to second-guess the district court and re-apportion fault.

This second-guessing is particularly violative of the clear error standard in regard to the judgment against Frank Horsfall which the Sixth Circuit vacated. Horsfall testified twice under oath that he had destroyed documents. Then, after the hearing on sanctions, Horsfall claimed to have found them. Despite the district court's finding that Horsfall's testimony was "void of credibility" (App. 105), the Sixth Circuit had a different view and threw out all sanctions against Horsfall.

Without reference to the clear error standard, the Sixth Circuit found that

1) "it appears" Gysler was not at fault (App. at 21);
2) Horsfall was "not motivated by bad faith" (*Id.* at 22);
3) Horsfall "impeded discovery . . . it seems, only out of a legitimate fear of retaliation." (*Id.*); and
4) "we feel that Gysler's conduct did not cross this threshold" (*Id.* at 26).

The Court's vacatur of the judgment based on its "feel" that the question was "close" is the kind of second-guessing which the clear error standard prohibits.

C. The Standard of *National Hockey League* Promotes the Sound Public Policies of Preserving Judicial Resources for All Litigants and Maintaining Public Trust in the System.

As disturbing as the Sixth Circuit's lack of deference to the district court's choice of sanctions and findings of fact, is the Court's intimation that ultimate sanctions are not appropriate because of the commercial nature of the disputes and

the fact that foreign parties were involved. Neither of these factors is supported by the text of Rule 37 or the case law interpreting it.

The Court of Appeals repeatedly referred to the case as a "commercial dispute" (App. 1, 3), and excused the defendants' misbehavior by taking judicial notice that "a certain amount of resistance and wrangling during the discovery process is the norm rather than the exception, especially in international commercial litigation involving sophisticated litigants and high stakes." (App. 26-27).

The Sixth Circuit's judicial amendment to Rule 37 is sweeping. Apparently, neither commercial litigants nor litigants who have the misfortune to become involved in disputes with foreign companies will have the benefit of fair discovery. When the stakes are "high" and the litigants "sophisticated," documents may be withheld despite court orders for production; documents may be destroyed and then appear at the last moment; and frivolous legal arguments may be repeated and repeated even after having been rejected by the district court. Effectively, rules of ethics and candor to the court are suspended!

Other courts of appeals have rejected the sporting-chance theory of discovery used by defendants in this case, whereby defendants sought to withhold discovery until they were held in default. If the " 'parties are allowed to flout their obligations, choosing to wait to make a response until a trial court has lost patience with them, the effect will be to embroil trial judges in day-to-day supervision of discovery, a result directly contrary to the overall scheme of the federal discovery rules.' " *Weisberg v. Webster,* 749 F.2d at 871.

In *G-K Properties,* 577 F.2d 645, the plaintiff produced the documents requested three days prior to the hearing on defendants' dismissal motion. Despite plaintiff's production of the documents, the district court dismissed the case, and the Ninth Circuit affirmed.

> We encourage such orders. Litigants who are willful in halting the discovery process act in opposition to

> the authority of the court and cause impermissible prejudice to their opponents. It is even more important to note, in this era of crowded dockets, that they also deprive other litigants of an opportunity to use the courts as a serious dispute-settlement mechanism.

Id. at 647; *Weisberg*, 749 F.2d at 872.

Solid public policy interests support the standards articulated by this Court in *National Hockey League*. Permitting sophisticated clients with sophisticated counsel to abuse the discovery process without sanction will cause other litigants to lose faith in the system and waste the resources of the courts on meaningless procedures designed not to move the case toward a determination on the merits, but to forever prevent the case from reaching such a point.

The Sixth Circuit's reversal of sanctions rewards defendants for their bad behavior. Other litigants now know that they are free to resist discovery with little risk of any sanction, given the ease with which considered decisions by the district court may be vacated. The district court's attention to detail and fairness in this case is virtually unparalleled, as demonstrated by its detailed findings and multiple invitations to respondents to be heard. If this default is not upheld, none will satisfy the "reluctance" of the Sixth Circuit. Those litigants who can afford to resist, will resist, now that the threat of "the ultimate sanctions" has been removed. Discovery is a key element of modern litigation and the Sixth Circuit's decision encourages bad behavior.

Federal Rule of Civil Procedure 1 provides that the rules "shall be construed to secure the just, speedy, and inexpensive determination of every action." The district court determined that, after two years, defendants' discovery abuses had rendered this case untriable. The district court's assessment in this regard should be respected under the standards set forth in *National Hockey League*.

II. IN DIRECT CONTRAVENTION OF THE HOLDING OF THIS COURT IN *CHAMBERS V. NASCO, INC.*, THE COURT OF APPEALS VACATED THE DISTRICT COURT'S AWARD OF ATTORNEY FEES PURSUANT TO ITS INHERENT POWER ON THE GROUND THAT THE FEES AWARDED WERE NOT ALL ATTRIBUTABLE TO SPECIFIC VIOLATIONS OF FEDERAL RULE 37.

The district court's opinion in this case relied on its inherent power under Article III of the Constitution and this Court's decision in *Chambers v. NASCO, Inc.*, 501 U.S. 32 (1991), in awarding attorney fees against defendants. (App. 118-120). The Sixth Circuit in vacating the award, relied on pre-*Chambers* case law, which required that the fees awarded be limited to those caused by specific failures to obey court orders. (App. 28-29). The Sixth Circuit never addressed the district court's award of sanctions under its inherent powers.

This Court in *Chambers* specifically rejected the limitation imposed by the Sixth Circuit in this case. In *Chambers*, this Court held that the statutes and procedural rules which provide for an award of attorney fees "are not substitutes for the inherent power, for that power is both broader and narrower than other means of imposing sanctions." *Id.* at 46. "[T]he inherent power of a court can be invoked even if procedural rules exist which sanction the same conduct." *Id.*

> In circumstances such as these in which all of a litigant's conduct is deemed sanctionable, requiring a court first to apply rules and statutes containing sanctioning provisions to discrete occurrences before invoking inherent powers to address remaining instances of sanctionable conduct would serve only to foster extensive and needless satellite litigation, which is contrary to the aim of the rules themselves.

Id. at 49. *See also id.* at 155 (Scalia, Justice, dissenting) ("an overall sanction resting at least in substantial portion upon the court's inherent power need not be broken down into its component parts.").

The decision of the Sixth Circuit directly conflicts with this Court's recent decision in *Chambers* and, therefore, the writ should issue so that *Chambers* is not rendered a dead letter.

III. THE HOLDING OF THE SIXTH CIRCUIT IS DIRECTLY CONTRARY TO THE TEXT OF FEDERAL RULE 37 WHICH REQUIRES AN AWARD OF ATTORNEY FEES ABSENT SPECIFIC FINDINGS THAT THE FAILURE TO PROVIDE DISCOVERY WAS "SUBSTANTIALLY JUSTIFIED" OR THAT AN AWARD OF FEES WOULD BE "UNJUST".

The district court entered judgment against defendants and defense counsel for plaintiff's attorney fees and costs incurred in opposing defense counsel's obstructive tactics. After judgment was entered, defense counsel obtained their own counsel and turned on their clients. Defense counsel submitted that they failed to defend themselves earlier because they had an ethical duty to zealously represent their clients even if that meant deceiving GES and the district court.

The district court rejected defense counsels' affidavits and reiterated its finding that defense counsels' conduct was "egregious and sanctionable." (App. 144). Nevertheless, the district court vacated the judgment against defense counsel. The Sixth Circuit agreed that the district court had failed to find that the textual prerequisites of Rule 37 had been met, but nevertheless, affirmed the district court's vacatur of the award against counsel.

"Both parties and counsel may be held personally liable for expenses, 'including attorney's fees' caused by the failure to comply with discovery orders". *Roadway Express, Inc. v. Piper,* 447 U.S. at 763. Rule 37(b) provides that "the court shall require the party failing to obey the order or the attorney advising that party or both to pay the reasonable expenses, including attorney fees, caused by the failure, *unless the court finds that the failure was substantially justified or that other*

circumstances make an award of expenses unjust." (Emphasis added).

Rule 37 was revised in 1970 to make an award of attorney fees and costs against the losing party and attorney mandatory "in an attempt to induce courts to make the award more frequently." 8 Wright & Miller, *Federal Practice & Procedure,* §2281 at 756. "The rule now makes the award mandatory, regardless of what other sanctions may be imposed." 8 Wright & Miller, *Federal Practice & Procedure* §2289 at 792. The Advisory Committee found that "an award of expenses and fees is 'virtually the sole formal sanction in the rules to deter a party from pressing to a court hearing frivolous requests for or objections to discovery' and that it is 'the most important sanction to deter abusive resort to the judiciary.' " *Id.* at §2288 at 786.

Once conduct is found to be sanctionable, Rule 37 establishes two *textual* prerequisites, at least one of which a party or counsel must prove in order to avoid sanctions. Rule 37 "places the burden on the disobedient party to avoid expenses by showing that his failure is justified or that special circumstances make an award of expenses unjust." Advisory Committee Note to 1970 Amendment to Rule 37. *See First American Bank v. Milnikel,* 897 F.2d 319, 331 (8th Cir. 1990). The First Circuit has applied Rule 37 according to its text.

> The clear language of the Rule imposes a duty on the district court that was not met in this case. It made no findings "that the failure [to obey its orders] was substantially justified or that other circumstances make an award of expenses unjust." Because this was in direct contravention of the requirements of the rule, there must be a remand.

Metrocorps v. Eastern Mass. Jr. Drum & Bugle Corps, 912 F.2d 1, 2 (1st Cir. 1990).

Members of this Court have recognized that judges are not inclined by nature to impose sanctions, but must be required to do so when the substantive prerequisites for sanctions are met. "Judges, like other human beings, do not like imposing punishment when their duty does not require it,

especially upon their own acquaintances and members of their own profession. They do not immediately see, moreover, the system wide benefits of serious . . . sanctions, though they are intensely aware of the amount of their own time it would take to consider and apply sanctions in the case before them." *Amendments to the Federal Rules of Civil Procedure*, 61 U.S.L.W. 4392 (Scalia, J., dissenting).

The Federal Rules of Civil Procedure should promote uniformity and predictability. The *ad hoc* approach of the district court and court of appeals undermines these goals, and permits sanctions to be imposed and fees awarded in a standardless and potentially discriminatory manner. Congress and this Court have set forth specific textual prerequisites for counsel to prove before they can avoid an award of attorney fees and costs. Defense counsel did not meet their burden of proof, and neither the district court nor the Sixth Circuit found that they had. Under these circumstances, this case should be heard by this Court to advise the lower courts whether Rule 37's mandatory award of attorney fees and costs has any meaning, or whether such provision and those provisions setting forth respondents' burden are mere surplusage which should be stricken from the Rule.

IV. THE COURT OF APPEALS ERRED IN REMOVING THE DISTRICT JUDGE WHERE NO OBJECTION WAS RAISED BY DEFENDANTS UNTIL APPEAL AND WHERE THE COURT OF APPEALS FOUND NO GROUND FOR RECUSAL UNDER 28 U.S.C. §455.

Before the district court, GES was represented by co-counsel for different firms. Several months into the case, and after several motions had been filed and were pending, the district judge removed himself from the case, apparently because he had retained at that time as his own counsel a partner in one of the firms representing GES, a partner who was not involved in this case. After the district judge removed himself, that law firm withdrew as counsel to GES in this case. Remaining co-counsel asked that the

case be re-assigned to Judge Battisti due to his familiarity with the issues, and Chief Judge Lambros, receiving no objections from defendants who were duly and extensively notified of all facts relating to the issue, re-assigned the case to Judge Battisti. *Defendants made no objection to the re-assignment until vears later on appeal after judgment had been rendered against them.*

Since defendants had not challenged Judge Battisti's re-assignment in the lower court, the issue came to the Court of Appeals on review of Judge Lambros' unopposed re-assignment of the case to Judge Battisti. Defendants based their recusal appeal on what they admitted were "otherwise innocuous actions" by a judge they characterized as an "ugly American." (Horsfall Brief at 9). The Court of Appeals found no violation of Section 455(a), but awarded defendants a second chance with a new judge by removing Judge Battisti from the case. (App. 29-30).

The Sixth Circuit's removal of Judge Battisti rewards the defendants' sporting-chance strategy of litigation, withholding the recusal motion and taking their chance with the district court and then, faced with an adverse judgment, raising the issue for the first time on appeal. The courts of appeals consistently conclude that where a party has not filed a motion for recusal pursuant to 28 U.S.C. §455 in the district court, the party may not pursue the issue on appeal. The requirement of a timely motion is to "prohibit the knowing concealment of an ethical issue for strategic purposes." *United States v. York*, 888 F.2d 1050, 1055 (5th Cir. 1989).

Defendants sought recusal based on the rulings of the district court which were adverse to them and assumed that the basis for those decisions was not their own misconduct, but some previously unexpressed bias or prejudice which the district judge harbored toward them. However, " '[p]artiality' does not refer to favoritism, but only to such partiality as is, for some reason, wrongful or inappropriate." *Liteky v. United States*, 510 U.S. ___, ___ S. Ct. ___, 127 L.Ed.2d at 474, 489 (1994).

> The judge who presides at a trial may, upon completion of the evidence, be exceedingly ill disposed towards the defendant, who has been shown to be a thoroughly reprehensible person. But the judge is not thereby recusable for bias and prejudice, since his knowledge and the opinion it produced were properly and necessarily acquired in the course of the proceedings, and are indeed sometimes (as in a bench trial) necessary to completion of the judge's task.

Id. at 488.

> *Not* establishing bias or partiality . . . are expressions of impatience, dissatisfaction, annoyance, and even anger, that are within the bounds of what imperfect men and women, even after having been confirmed as federal judges, sometimes display.

Id. at 491.

If, as the court of appeals suggests, there was no basis for finding that Judge Lambros erred in re-assigning Judge Battisti to this case, there is no reason to remove him from the case on remand. "It has long been regarded as normal and proper for a judge to sit in the same case upon its remand. . . . " *Id.* at 488. Under these circumstances, the Sixth Circuit erred in removing Judge Battisti from the case based on complaints from defendants about the result, since Judge Battisti's extensive and authoritative opinions resulted from his experience with defendants and their counsel in this case.

CONCLUSION

The Sixth Circuit's decision in this case represents a clear attempt by a Court of Appeals to legislate new standards for the application of discovery sanctions which are different from those set forth in Federal Rule 37 and the decisions of this Court in *National Hockey League* and *Chambers v. NASCO.* Although this Court spoke loudly and clearly in setting forth such standards in *National Hockey League* and *Chambers,* those standards have not been heeded by the Sixth Circuit in a series of cases over the past decade.

The Sixth Circuit's decisions second-guessing district judges discourages them from acting to correct abuse and misuse of the discovery rules. As Chief Justice Burger noted in his Annual Report on the State of the Judiciary, "[w]here the power lies with judges to prevent or correct abuse and misuse of the system, judges must act." Address to American Bar Association Mid-Year Meeting, 6 (Feb. 3, 1980). Given the desirable goal of promoting nationwide uniformity in application of rules of practice and procedure, and the growing body of case law demonstrating the Sixth Circuit's admitted "reluctance" to apply Rule 37, it is appropriate for the writ to issue.

Respectfully submitted,

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APPENDIX

Nos. 92-4110; 92-4111; 92-4112; 92-4113; 92-4114

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

GENERAL ENVIRONMENTAL SCIENCE CORP.,

Plaintiff-Appellee/
Cross-Appellant.

v.

FRANK L. HORSFALL; JOHN L. STRAUSS; BIOSYS CORPORATION; GUSTAVO GYSLER,

Defendants-Appellants,

STEPHEN WALTERS; JASON C. BLACKFORD; THOMAS C. BUFORD,

Cross-Appellees.

_____/

On Appeal from the United States District Court for the Northern District of Ohio

(Filed May 25, 1994)

NOT RECOMMENDED FOR FULL-TEXT PUBLICATION

Sixth Circuit Rule 24 limits citation to specific situations. Please see Rule 24 before citing in a proceeding in a court in the Sixth Circuit. If cited, a copy must be served on other parties and the Court. This notice is to be *prominently* displayed if this decision is reproduced.

Before: MILBURN and GUY, Circuit Judges; and BROWN, Senior Circuit Judge.

PER CURIAM. In this commercial dispute, plaintiff moved the district court for sanctions, citing what it perceived to be defendants' and defense counsel's abuse of the discovery process. The district court granted plaintiff's motion and imposed the ultimate sanction against defendants by entering a default judgment against them. The court also sanctioned defense counsel by holding them jointly and severally liable for plaintiff's attorneys' fees and expenses. Subsequently, defense counsel successfully moved the court to amend its order, thereby eliminating their own, if not their clients', liability under the judgment.

Defendants now appeal the default judgment entered against them as well as the district court's award of damages. Plaintiff cross-appeals, arguing that the district court erred in reversing its decision to sanction defense counsel. For the following reasons, we vacate the default judgment and remand for proceedings consistent with this opinion. With regard to plaintiff's cross-appeal, on the other hand, we affirm.

I. FACTUAL BACKGROUND AND PROCEDURAL HISTORY

This case, with its long and labyrinthine procedural history, arises out of a commercial dispute between plaintiff General Environmental Science Corporation ("GES"), an Ohio corporation, and defendants Frank L. Horsfall, John L. Strauss, Gustavo Gysler, and Biosys Corporation, S.A., a Swiss corporation. GES specializes in the manufacture, distribution, and sale of microbiological products.

GES's-principal product, commonly referred to as "LLMO," is used to treat sewage and aquarium water.

In November 1989, GES and Biosys, which was known as X-O Corporation at the time, entered into an agreement ("LLMO Agreement") establishing Biosys as GES's exclusive distributor for selected European countries. This agreement contained (1) a definition of "trade or business secrets"; (2) a clause prohibiting Biosys and its employees from manufacturing, distributing, or selling products competitive with GES products for the duration of the agreement plus one additional year thereafter; (3) a guarantee by GES that it would maintain the quality of its products; (4) a provision permitting either party to cancel the agreement "should Distributor not fulfill minimum quantities during a given year [ ]" (app. 81); and (5) a choice of law/forum selection clause.

At the time, Gysler, Horsfall, and Strauss not only held substantial ownership interests in Biosys,[1] but also were high-level company employees: Gysler was Biosys's "administrator" – the equivalent of its chief executive and financial officer; Horsfall was its technical director; and Strauss was in charge of planning and directing marketing strategies. That GES would retain Biosys as a distributor was explained in part by the fact that both Horsfall and Strauss had previously worked for GES, Horsfall having served as a consultant and as Vice President of

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[1] Strauss, however, sold his interest (58%) to his father-in-law sometime in November 1989.

Research and Development and Strauss as a sales representative to Europe and the Middle East.[2]

Despite indications that both GES and Biosys were profiting from their still-nascent agreement, the deal they had struck soon went sour. Citing problems with the quality of GES's products. Biosys informed GES in May 1990 that it was terminating their relationship. For Biosys, however, the end of this endeavor would mark the beginning of another one; on the same day the death knell sounded for Biosys's agreement with GES, Gysler formed Biosphere, S.A., a company that was, in many respects, indistinguishable from Biosys. As GES observes, Biosys and Biosphere shared the same directors, managers, employees, business purposes, and telephone and facsimile facilities. Moreover, the companies even sold products under substantially identical names.

GES did not attribute the coincidence of these two maneuvers or the similarity between Biosys and Biosphere to mere fortuity. Instead, GES filed the instant action, claiming that defendants had created Biosphere as an "alter ego" corporation to unlawfully compete with GES.[3] In addition to listing numerous state tort claims,

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[2] Horsfall and Strauss, then, were privy to much sensitive and confidential company information. At GES's insistence, Horsfall and Strauss had each signed contracts requiring that they preserve trade secrets and not compete with GES.

[3] Gysler and Biosys provide a different account of the ostensible purpose behind the formation of Biosphere. They maintain that, due to the problems they were experiencing with the quality of GES's goods, "[t]he reputation and credibility of Biosys and its representatives in Europe among European customers began to take a beating." (Appellants Gysler's and

GES's 18-count complaint alleged misappropriation of trade secrets, violations of agreements not to compete, and violations under the Racketeer influenced and Corrupt Organizations Act ("RICO").[4] GES sought money damages and a declaratory judgment, as well as injunctive relief prohibiting defendants from competing with GES and from using its trade secrets.

Subsequently, the district judge (Battisti, J.) denied GES's motion for a temporary restraining order and ordered expedited discovery to be completed by September 30, 1990. The judge also set October 29, 1990, as the hearing date for GES's preliminary injunction motion. Discovery began in earnest on August 3, 1990, when GES served defendants with its first set of interrogatories and

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iosys's Brief at 12.) They had hoped that Biosphere would thus rovide a "means to continue satisfying the customers in urope despite mounting liability potential to them." (*Id.*)

[4] The affidavit of Karl F. Ehrlich, taken July 25, 1990, provided support for GES's claims. According to Ehrlich, a GES ustomer,

> [b]etween August 1989 and December 1989, [Horsfall and Strauss] would call me (Strauss would sometimes call 3 to 4 times a week) to acquire information about aquaculture and aquarium applications and to complain about GES products and management. They also indicated that they [Biosys] were entering a contract for distribution with GES that they never intended to honor, and that they planned in the future to break this contract as soon as they could set up their own production facilities and that they would use product variability and potency as a basis for breaking the contract and competing.

a request for production of documents.[5] In addition, on August 13, 1990, and August 14, 1990, GES served notices of deposition on Horsfall and Strauss, respectively. Horsfall responded by moving for a protective order and requesting an extension of his deposition date. Regarding the former, he noted that revealing the trade secrets of his employer might subject him to prosecution under Article 273 of the Swiss Penal Code, which provides in pertinent part:

> "Whoever makes available a manufacturing or business secret to a foreign governmental agency or a foreign organization or private enterprise or to an agent of any of them; shall be subject to imprisonment and in grave cases to imprisonment in a penitentiary.
>
> The imprisonment may be combined with a fine."

United States v. Vetco, Inc., 691 F.2d 1281, 1287 (9th Cir.), *cert. denied*, 454 U.S. 1098 (1981); *see also id.* ("The term 'business secret' has been defined to include 'all facts of business life to the extent that there are interests worthy of protection in keeping them confidential.' ")

On August 29, 1990, Horsfall answered GES's complaint and asserted a counterclaim. Horsfall also filed a motion for leave to apply Swiss law to the interpretation of the LLMO Agreement and to the definition of trade secrets. Thereafter, Horsfall was deposed for four days. During his deposition, Horsfall responded to most, but

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[5] Although all defendants eventually answered GES's first set of interrogatories, only Horsfall and Strauss did so within the expedited time frame established by the district court.

not all, of GES's questions. Under instructions from Gysler, Horsfall declined to answer some questions for fear that, by answering, he would thereby subject himself to criminal charges in Switzerland.

Concluding that discovery in the instant action was governed by American, not Swiss, law and characterizing Horsfall's argument based on Article 273 (the "Swiss Penal Code Objection") as "nothing more than slight of hand" (app. 197), the district judge denied Horsfall's motion for a protective order on September 14, 1990 ("September 14 order"). For both Horsfall and Strauss, the timing of the judge's ruling was somewhat inauspicious. As Horsfall points out, by the time the judge issued this ruling, he had already answered GES's interrogatories, and his deposition was already completed. Strauss, on the other hand, did not learn of the ruling until sometime after his own deposition commenced on September 19, 1990. Thus, when Strauss served GES with his interrogatory answers on September 18, 1990, and when he fielded questions early on in his deposition, he did so under the assumption that he could be unresponsive to the extent Swiss law would proscribe, under threat of criminal prosecution, disclosure of the requested information. When Strauss finally did learn of the judge's order, he answered questions regarding Biosys, although he declined to answer those involving trade secrets of Biosphere.

The September 14 order did little to stem the pace or volume of the motion practice in this case. For instance, on September 20, 1990, GES filed a motion to compel discovery. Five days later, Biosys and Gysler, a Swiss national, moved the court for a protective order against

requiring them to travel to Cleveland for their scheduled depositions. Then, on October 19, 1990, all defendants sought a protective order preventing the disclosure of trade secrets and other confidential information contained in various patent applications that were subject to discovery by GES. In addition, on October 29, 1990, arguing that GES had not answered interrogatories that had been served on the company in August, Horsfall filed his own motion to compel discovery.

A hearing on GES's September 20 motion to compel, which challenged the validity of the Swiss Penal Code Objection as it pertained to Biosphere and the trade secrets at issue, was held on February 6, 1991. Before ruling on the matter, however, the district judge, *sua sponte,* disqualified himself from the case pursuant to Local Rule 7.09(1). The circumstances underlying Judge Battisti's decision, though not themselves the subject of this appeal, are worth mentioning. On February 13, 1991, the Cleveland Plain Dealer published a report identifying Robert Rotatori as the attorney Judge Battisti had retained to represent him in an on-going federal investigation into his handling of a 1988 case. As it turned out, Rotatori was a partner in the law firm of Gold, Rotatori, Schwartz & Gibbons ("Gold, Rotatori"), one of two firms that, as of February 1991, was representing GES in the instant action.

The day after Judge Battisti issued his order of disqualification, Niki Z. Schwartz and Richard L. Stoper, Jr., the Gold, Rotatori attorneys handling the GES matter, moved the court to withdraw as co-counsel for GES. In the aftermath of Gold, Rotatori's withdrawal, Jerome

Weiss of Weiss & Associates, now the only firm representing GES, urged Judge Battisti to seek reassignment to the case. Weiss maintained that any appearance of impropriety had been cured by Gold, Rotatori's withdrawal. Judge Battisti evidently agreed, for he subsequently urged Chief Judge Thomas Lambros to reassign him to the case, stating:

> Mr. Weiss has requested that I maintain the case on my docket. In light of the extensive wrangling involved in the discovery process to date, it seems that it is in nobody's interest to start the whole process over again before another judge. Inasmuch as I have already recused myself, the matter is in your hands. I have no objection to the reassignment of this case to my docket.

(App. 1919.) Judge Lambros granted his colleague's request on March 6, 1991.

Picking up where the case had left off, Judge Battisti issued an order on April 4, 1991 ("April 4 order"), in which he took a number of actions. For instance, noting that "the evidence presented by the Plaintiff is overwhelming" and that GES "seeks to acquire documents that go to the very heart of its allegations," *General Envtl. Science Corp. v. Horsfall*, 136 F.R.D. 130, 132 (N.D. Ohio 1991), he granted GES's motion to compel discovery and for attorneys' fees. He also reaffirmed his rejection of defendants' Swiss Penal Code Objection, directing defendants to produce documents from Switzerland (including those pertaining to Biosphere) and to make themselves

available for deposition within 20 days.[6] In addition, he granted Horsfall's motion to compel discovery, although he acceded to GES's request for a confidentiality order in this regard. Finally, Judge Battisti denied defendants' collective and Gysler's and Biosys's separate motions for a protective order.

On April 18, 1991, GES noticed defendants that their depositions were to take place on April 22, 1991. Prior to the expiration of the deadline set forth in the court's April 4 order, defendants assured GES that they were making a good faith effort to cooperate in the discovery process. Notwithstanding these assurances, defendants were not deposed nor did they produce documents before the 20-day period elapsed. Indeed, by the time document production began on April 30, 1991, GES already had filed a motion for sanctions, seeking default judgment against all defendants for their failure to abide by the terms of the court's order and attorneys' fees against both defendants and defense counsel. GES's motion recounted specific instances of alleged misconduct on the part of defense counsel, including their continued reliance on the Swiss Penal Code Objection, notwithstanding the court's prior rulings on the matter; their failure to promptly notify all defendants about the substance of the court's April 4 order; and their failure to

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[6] Defendants maintain that because defense counsel received Judge Battisti's April 4 order on April 8, they actually had only 16, not 20, days to comply with its terms. Horsfall adds that he was in Europe at the time, and thus was not informed of the judge's ruling until mid-April.

appear for the properly noticed depositions of their clients.

Defendants and their counsel responded by filing two motions of their own. First, on May 1, 1991, defense counsel requested additional time to respond to GES's motion "to allow for adequate time for counsel and to clarify whether and to what extent conflicts may be raised by the nature of the motion to compel." (App. 901.) The possibility of conflict arose in this instance, defense counsel observed, "in that the motion seeks sanctions both against counsel and the parties for alleged discovery failures and/or violations of court orders." (App. 900.) The following day, defendants moved the court to extend the 20-day time period for completion of discovery established by its April 4 order. Judge Battisti considered these motions along with GES's motion to compel at a hearing held on May 15, 1991. At this hearing, the judge ordered defendants to comply with GES's discovery requests by May 21, 1991, and "warned defense counsel that further intransigence on Defendants' part could lead to the imposition of ultimate sanctions." *General Envtl. Science Corp. v. Horsfall,* 141 F.R.D. 443, 447 (N.D. Ohio 1992).

On May 24, 1991, pursuant to Gysler's instructions, defendants filed under seal "A7077," a Biosphere document "contain[ing] formulations of various products and constitut[ing] a trade secret of the most sensitive nature." (App. 962.) In their filing, defendants asserted that they "are prepared to satisfy this Court **in camera**, short of disclosure to Plaintiff or to Plaintiff's counsel, that the formulations on document A7077, differ in type and kind from the formulations of Plaintiff's products to which any

Defendant herein had access at any time in the past." (App. 962-63.).

Also on May 24, 1991, Judge Battisti issued an order ("May 24 order") requiring defendants to produce all requested documents and directing defendants Horsfall, Strauss, and Gysler to appear for depositions on May 28, June 4, and June 11, respectively. The order also awarded GES costs and attorneys' fees incurred in attempting to obtain defendants' compliance with the April 4 order and enjoined defendants from engaging in various activities, such as competing with GES in the manufacture, distribution, or sale of microbiological products and using GES trade secrets.

The fact that defendants' depositions took place as scheduled[7] did not stop GES from renewing its motion for sanctions on August 27, 1991. Again, GES sought a default judgment and injunctive relief. Although GES also alleged that defendants had violated the court's May

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[7] Defendants evidently were more forthcoming during this second round of depositions. Horsfall, for one, claims that he answered all questions asked of him without once asserting an objection based on Swiss law. Strauss, too, maintains that the so-called Swiss Penal Code Objection was a nonfactor in his deposition and that, to the extent he declined to answer some questions, he did so only on attorney-client privilege grounds.

While at least some of the defendants may thus have been more amenable, according to GES, the same cannot be said for defense counsel Stephen Walters. Not only was Walters, in GES's estimation, blatantly disdainful of the district judge and plaintiff's counsel, but also he denied the existence of various court orders. Moreover, GES alleges that defense counsel advised defendants that, through Biosphere, they could continue to compete with GES despite the court's May 24 order.

24 injunction (prohibiting competition and the use of trade secrets), the primary basis for GES's motion was defendants' filing of A7077. GES argued that defendants' filing of A7077 under seal was, in effect, a ruse designed to withhold evidence already deemed discoverable by the court.[8] In fact, the company asserted that, by filing the document under seal, defendants contravened the "Order of Confidentiality entered on April 4, 1991 which the Court had entered by way of rejecting defendants' claims that confidential documents could be withheld from plaintiffs." (App. 979.) Moreover, GES disparaged defendants' rationale for not producing the document. Defendants had argued that the court implicitly approved of their actions with respect to A7077 by not mentioning the document in its May 24 order. As GES pointed out, however, given the fact A7077 was filed only 13 minutes before the ruling was issued, the judge most likely did not even consider, let alone authorize, the filing.

On November 6, 1991, remarking that Biosphere had authorized its release, defendants finally provided GES with a copy of A7077. Then, on November 22, 1991, GES filed a supplemental memorandum charging that defendants had, beginning in August 1990, systematically destroyed predecessor documents to A7077. GES argued that these earlier documents would have facilitated its effort to determine "which of plaintiff's trade secrets defendants used to develop the products they currently

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[8] Horsfall hastens to note that he not only favored the release of A7077 for GES's review, but also answered (to the extent his memory permitted) questions regarding the document during deposition.

sell." (App. 1593.) In all, six generations of the A7077 document, each representing different stages in the evolution of defendants' products, were alleged to have been destroyed. GES singled out Horsfall, who, GES maintained, destroyed not only the documents themselves but also the notes that accompanied them. GES impressed upon the court that such destruction occurred while discovery requests were pending.

GES's memorandum also urged the imposition of sanctions against defense counsel, based in part on counsel's handling of A7077. GES argued that sanctions were appropriate because "[c]ounsel has been implicated in this case from the very beginning." (App. 1666.) In particular, GES alleged that defense counsel (1) approved of defendants' "scheme which led to this entire case" (*id.*) (footnote omitted); (2) "engag[ed] in every possible obstructive discovery tactic" (*id.*); (3) contributed to the destruction of evidence; (4) withheld A7077 in violation of the court's discovery orders; and (5) advised defendants that they could continue to compete with GES despite the court's prior ruling to the contrary.

Defense counsel first learned of this latest salvo on November 25, 1991, the day before the scheduled hearing on GES's renewed motion. Defense counsel proceeded to prepare a responsive memorandum that denied GES's allegations, while noting that "[a]t this eleventh hour with the Defendants thousands of miles away, counsel for Defendants cannot respond fully." (App. 1710 n.2.) Arguing that GES offered no evidence to support its claims, the memorandum also disputed the propriety of sanctioning defense counsel. The hearing on GES's motion for sanctions took place as scheduled on November 26, 1991.

At this hearing, Horsfall denied having destroyed documents pertaining to the instant action. On cross-examination, however, he acknowledged that he "discarded" sheets of paper detailing different product formulations.[9] At the close of the hearing, Judge Battisti instructed GES's counsel to submit proposed findings of fact and conclusions of law within 10 days.

Horsfall returned to Switzerland after the hearing and, upon searching his office, was able to locate two of the six A7077 predecessor documents previously thought lost. On December 2, 1991, Horsfall faxed the documents to Gysler and defense counsel. GES maintains that defense counsel did not promptly inform plaintiff's counsel of Horsfall's discovery even though they knew GES was in the process of drafting proposed findings of fact and conclusions of law. Only after plaintiff's counsel had filed their findings and conclusions on December 6, 1991, did defense counsel then provide GES with these predecessor documents.

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[9] Indeed, as the district court would eventually find:

> Defendants admit that predecessor documents to Document A7077 existed. The first such document was created in October 1990. Six successor documents were created and additions, deletions and modifications were made to the "working document" from time to time. These documents would purportedly trace the development of Defendants' products from the date they terminated their contract with GES. Horsfall admits destroying the predecessor documents to Document A7077. According to Horsfall, the destruction continued from October 1990 to April or May 1991.

141 F.R.D. at 448 (citations omitted.)

On March 10, 1992, Judge Battisti granted GES's renewed motion for sanctions and entered a default judgment against defendants pursuant to Rule 37 of the Federal Rules of Civil Procedure. Judge Battisti also ordered defendants and their counsel to pay all attorneys' fees and costs expended by GES. Specifically, Judge Battisti found that defendants' failure to produce A7077, coupled with their destruction of its predecessors, prejudice GES in the pursuit of its claims and that defendants had engaged in competition with GES in violation of the court's May 1991 injunction. Judge Battisti further concluded:

> 8. Defendants have repeatedly attempted to relitigate points of law decided against them. Defendants have continued to invoke Swiss law as a shield against discovery even though this position was rejected by the Court less than two months after the case was filed. Defendants have also attempted to relitigate the issue of confidentiality despite the Order of Confidentiality contained in the April Order. Finally, Defendants repeatedly have rejected to discovery on the grounds that Biosphere is not a party to this litigation despite the April Order finding that "Gysler, Strauss and Horsfall, in particular, as owners and employees of Biosphere, have no right to refuse to provide the information requested by Plaintiff."

141 F.R.D. at 451.

On May 29, 1992, in addition to entering a default judgment for GES in the amount of $11,861,658.17, Judge Battisti awarded GES attorneys' fees and costs totalling $268,284.64 ("May 29 order"). Judge Battisti arrived at the

former figure by trebling GES's actual damages pursuant to RICO and then adding this sum ($3,953,886.39) to a punitive damages award of $7,907,772.78, which itself was determined by doubling GES's already-trebled actual damages. Defense counsel subsequently moved the court to alter or amend the judgment in an attempt to eliminate their liability under the May 29 order. Judge Battisti granted the motion on September 16, 1992.

Both parties appealed, defendants as to the sanctions entered against them and GES as to Judge Battisti's order granting defense counsel's motion to alter or amend the judgment. Before these appeals were argued to this court, however, Strauss filed a personal bankruptcy petition. GES then moved this court to stay the appeal as to all defendants, arguing that the stay that automatically applied to Strauss should be extended to all defendants because defendants' separate appeals were inextricably intertwined. This court, however, disagreed and granted GES's motion only as to Strauss.[10]

II. DEFENDANTS' APPEAL

A.

At the outset, we reject Gysler's and Biosys's contention that the instant action is not properly in federal court. In this regard, Gysler and Biosys maintain that Judge

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[10] Although Strauss therefore is not technically a party before this court, our decision is, for obvious reasons, relevant to his bankruptcy proceeding. We leave to him the decision of what to do to avail himself of this decision in the bankruptcy court.

Battisti could not properly exercise jurisdiction over them because they are Swiss entities, and RICO, the court's only basis for federal question jurisdiction, does not provide for international service.[11] Nor does diversity jurisdiction exist, they add, because Horsfall is an Ohio resident.

Although we conclude that Gysler's and Biosys's argument is without merit, we do not quarrel with their interpretation of RICO's service-of-process provision. Instead, we note that Rule 4(i) of the Federal Rules of Civil Procedure and "the advisory committee's notes indicate that the authority for effecting foreign service can be found under federal *or* state law (of the state where the district court is located)." *Gould, Inc. v. Mitsui Mining & Smelting Co.*, 750 F. Supp. 838, 841 (N.D. Ohio 1990); *see also Brink's Mat, Ltd. v. Diamond*, 906 F.2d 1519, 1522 (11th Cir. 1990) ("Rule 4(e) permits a plaintiff to rely on either federal statutory authority or state law authority as to the amenability of a defendant to service of process, even if the state law authority extends beyond the express scope of the federal statutory authority.") (footnote omitted). "Therefore, foreign service for a RICO claim can be maintained when state law authorizes the foreign service."[12] *Gould*, 750 F. Supp. at 841.

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[11] The relevant RICO provision states: "All other process in any action or proceeding under this chapter may be served on any person in any judicial district in which such person resides, is found, has an agent, or transacts his affairs." 18 U.S.C. § 1965(d).

[12] The view enunciated in *Gould*, however, is not shared by all courts. *See generally Biofeedtrac, Inc. v. Kolinor Optical Enters. & Consultants, S.R.L.*, 817 F. Supp. 326, 331-32 (E.D.N.Y. 1993) (discussing disagreement among courts considering the issue).

Here, GES successfully contested below defendants' argument that their contacts with Ohio were insufficient to confer jurisdiction pursuant to Ohio's long-arm statute. *See* Ohio Rev. Code § 2307.382. Moreover, Gysler and Biosys were served with GES's complaint by certified mail, as authorized by Rules 4.3 and 4.5 of the Ohio Rules of Civil Procedure. On appeal, Gysler and Biosys challenge neither their service of process under the Ohio

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Some courts adhere to the notion that a "RICO action cannot be brought against persons who remain beyond this country's borders because such persons cannot be served." *Id.* at 332. The *Biofeedtrac* court set forth its reasons for not following these courts, reasons that we find persuasive:

> First, Rule 4(e) makes plain that parties may serve a summons as provided either by a federal statute or by the forum state's jurisdictional statute. Absent a plain statement in the RICO statute that persons outside the United States may not be served with process, this court will not ignore the second sentence in Rule 4(e).
>
> Second, Congress hardly would have immunized from RICO liability the foreign-based co-conspirators of a racketeering enterprise that conducts its activities here and that injures persons here. Nor would Congress have immunized one who engages in a continuous and systematic pattern of racketeering activity and who then retreats to an off-shore haven hoping to avoid service of process. This court will not construe Congressional silence with respect to extraterritorial service as a Congressional grant of immunity from such service.
>
> This court instead agrees with those courts that have concluded that even though the RICO statute does not provide for extraterritorial service upon persons outside the United States, plaintiff may look to the laws of the state in which the district court sits.

Id.

Rules nor Judge Battisti's ruling under the state's long-arm statute. Their jurisdictional challenge must therefore fail.

Equally unavailing is Gysler's and Biosys's assertion that the forum selection clause contained within the parties' LLMO Agreement mandates the GES's claims be litigated in Switzerland. The clause at issue provides that:

> This agreement shall be governed by the laws of Switzerland and the place of court is Rolle, Switzerland in case of claims from the PRINCIPAL. In case of claims by the DISTRIBUTOR, this Agreement shall be governed by the laws of the State of Ohio and the federal laws of the United States of America as applied by the United States Federal Courts in the State of Ohio.

(App. 82.) Gysler and Biosys now urge this court to rectify Judge Battisti's failure to give effect to this clause by dismissing GES's claims against them.

Specifically, Gysler and Biosys argue that, as a matter of sound policy, negotiated forum selection clauses not bearing indicia of fraud or coercion should be enforced. *See M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 12 (1972) ("The choice of that forum was made in an arm's-length negotiation by experienced and sophisticated businessmen, and absent some compelling and countervailing reason it should be honored by the parties and enforced by the courts."). Although they acknowledge that GES's complaint does not ostensibly represent a direct action for breach of contract, Gysler and Biosys maintain that the forum selection clause should nevertheless apply because GES's claims are, at root, predicated on the

LLMO Agreement. *See Lambert v. Kysar*, 983 F.2d 1110, 1121-22 (1st Cir. 1993) ("The better general rule, we think, is that contract-related tort claims involving the same operative facts as a parallel claim for breach of contract should be heard in the forum selected by the contracting parties."); *Rini Wine Co. v. Guild Wineries & Distilleries*, 604 F. Supp. 1055, 1058-59 (N.D. Ohio 1985).

Were Gysler's and Biosys's characterization of GES's claims accurate, we might be inclined to adopt their argument. In our view, however, Gysler and Biosys have misconstrued the essence of GES's suit. It is not, as they posit, fundamentally a contract action with related, yet subsidiary claims; rather, it is one for which the LLMO Agreement (and its terms) are simply one relevant, but not dominant, component. Indeed, in its complaint, GES does not pursue even a single claim based on a breach of the LLMO Agreement, "but focuses instead on claims for racketeering, theft of trade secrets and interference with contract which occurred well before that contract was ever executed." (Appellee's Brief in Response to Appeals of Gysler and Biosys at 22.) As Judge Battisti held:

> [GES] claims violations of the federal RICO statute, state statutes, and state common law. No contractual claims are made and no contract remedies sought. [GES] is entitled to try this case under its chosen theory. Accordingly, this court will not treat the instant action as arising out of the [LLMO Agreement]. Instead, it will be deemed to have arisen out of [GES's] ongoing business relationships with the Defendants. The [LLMO Agreement] is merely one of the final manifestations of those relationships, and as such, its terms cannot limit a comprehensive

> challenge to the Defendants' entire courses of conduct in this forum.
>
> This suit is, therefore, broader than the forum selection clause.

General Envtl. Science Corp. v. Horsfall, 753 F. Supp. 664, 667-68 (N.D. Ohio 1990). We are not persuaded that this conclusion should be disturbed.

B.

Next, we consider the propriety of the district court's action in ordering a default judgment in GES's favor. As this court has previously stated, under Rule 37:

> A district court may sanction parties who fail to comply with discovery orders in a variety of ways, including dismissal of their lawsuit or entry of default judgment against them. "It is well-established . . . that district court dismissal orders under this rule are reviewable only for abuse of discretion." Other circuits have recognized that this same standard of review applies to sanction decisions involving an entry of default judgment.
>
> Simply put, "if a party has the ability to comply with a discovery order and does not, dismissal," and we add or entry of default, "is not an abuse of discretion." Just as " '[d]ismissal of an action for failure to cooperate in discovery is a sanction of last resort that may be imposed only if the court concludes that a party's failure to cooperate in discovery is due to willfulness, bad faith, or fault,' " so, too, is entry of default judgment. Additional factors to consider in reviewing a district court's sanction decision

> under Fed.R.Civ.P. 37 include "whether the adversary was prejudiced by the dismissed [or defaulting] party's failure to cooperate in discovery, whether the dismissed [or defaulting] party was warned that failure to cooperate could lead to dismissal [or default], and whether less drastic sanctions were imposed or considered before dismissal [or default] was ordered."

Bank One of Cleveland, N.A. v. Abbe, 916 F.2d 1067, 1073 (6th Cir. 1990) (citations and footnote omitted). Our analysis of this issue is further informed by the harsh nature of the sanction in dispute as well as our well-established preference for trials on the merits. In *United Coin Meter Co. v. Seaboard Coastline Railroad*, 705 F.2d 839, 845 (6th Cir. 1983), we observed that "[j]udgment by default is a drastic step which should be resorted to only in the most extreme cases." In addition, we noted that "[t]rials on the merits are favored in federal courts and a 'glaring abuse' of discretion is not required for reversal of a court's refusal to relieve a party of the harsh sanction of default." *Id.* at 846; *see also Regional Refuse Sys. v. Inland Reclamation Co.*, 842 F.2d 150, 154-55 (6th Cir. 1988) (noting that this circuit has been less reluctant than others to reverse dismissals prompted by a party's failure to comply with discovery orders).

It is against this backdrop that we consider defendants' claim that Judge Battisti abused his discretion by entering the ultimate sanction of default judgment. It should be noted that, in advancing this argument, defendants have abandoned the strategy they pursued below of presenting a unified front. The approach they have adopted for their present purposes is perhaps most aptly

described as "each man for himself." Not surprisingly, this new approach has led to a certain amount of finger pointing, as the respective defendants (Horsfall and Strauss, in particular) attempt to deflect blame for the alleged discovery abuses to their codefendants, if not GES.

We agree that, if blame is to be apportioned among defendants, they would not receive equal shares.[13] Indeed, it appears that among the various defendants Gysler[14] was most at fault. With respect to Horsfall, for instance, we note that, as a 17 percent shareholder who was neither an officer nor a director of Biosphere, he was incapable of complying with GES's discovery requests absent the concurrence of, most notably, Gysler. As such, a default judgment is inappropriate in his case because he did not have the ability to comply with GES's discovery requests. *See Abbe*, 916 F.2d at 1073. Indeed, our decision to vacate the judgment as to Horsfall would not change

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[13] In this regard, we are mindful of Horsfall's contention that Judge Battisti should not have treated defendants monolithically. According to Horsfall, a more careful parsing of the record reveals that he did not, unlike Gysler, engage in the discovery abuses that are alleged to have occurred. For instance, Horsfall notes that he answered GES's complaint as well as the interrogatories addressed to him in a timely manner; subjected himself to eight days of depositions; product approximately 7,000 pages of documents; and even argued for the release of A7077 to GES – a suggestion that Gysler and defense counsel rejected.

[14] Gysler and Biosys joined in filing an appellate brief. For purposes of this opinion, our determinations regarding Gysler's conduct apply with equal force to the corporate defendant Biosys.

even assuming he did control the relevant documents, for his conduct during the discovery process was clearly not motivated by bad faith. *See id.* To the contrary, Horsfall appears to have offered the least discovery resistance of all defendants. Not only did he urge the production of A7077, but also he provided sensitive information about Biosphere in spite of Gysler's instructions. To the extent he impeded discovery, he did so, it seems, only out of a legitimate fear of retaliation from Gysler (not to mention Swiss authorities). And, although he admitted to discarding documents relevant to GES's claims, whether the documents in question were of a type that should have been preserved is far from settled.[15]

Of course, to resolve that Gysler is the most blameworthy defendant is not to conclude that a default judgment was appropriate in his case. To be sure, as an administrator for both Biosys and Biosphere, he not only had the ability to comply with GES's discovery requests,

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[15] Although Strauss, as noted above, is not a party to this appeal, our review of the record indicates that he, too, was not a principal culprit – at least vis-a-vis Gysler. Granted, as GES submits, Strauss may have had access to the documents requested by GES; whether he was in a position to command their production, however, is another matter. *See Estate of Young v. Holmes*, 134 F.R.D. 291, 294 (D. Nev. 1991) ("The relationship between the party and the person or entity having actual possession of the document is central in each case. The party must be able to command release of the documents by the person or entity in actual possession."); *see also United States v. International Union of Petroleum and Indus. Workers*, 870 F.2d 1450, 1452 (9th Cir. 1989) ("Conrol is defined as the legal right to obtain documents upon demand.") (citing *Searock v. Stripling*, 736 F.2d 650, 653 (11th Cir. 1984)).

but also could effectively prevent company underlings (codefendants included) from doing so – a power that, as Horsfall can attest,[16] was not at all times merely latent. Moreover, we cannot countenance Gysler's obstinate reliance on the Swiss Penal Code Objection as a basis for resisting those requests, notwithstanding the vehemency with which he may have disagreed with Judge Battisti's ruling on the matter. The question remains, however, whether, all things considered, Gysler's conduct was so willful and egregious that it merits the imposition of the ultimate sanction. Because we feel that Gysler's conduct did not cross this threshold, we vacate the default judgment as to him as well.

Although we are thus mindful that Gysler, in particular, was not completely forthcoming during discovery, we note that a certain amount of resistance and wrangling during the discovery process is the norm rather than the

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[16] In his brief, Horsfall contends that Gysler and Dudley Wright, another Biosphere administrator, ordered him not to divulge information relating to Biosphere. In a letter dated August 8, 1990, Gysler informed Horsfall of the consequences of not keeping quiet:

> We wish to remind you that as an employee of our Company, you are held to secrecy and confidentiality according to Swiss law and that the Swiss Penal Code art. 273 CPS provides criminal penalties for violating its provisions.
>
> We trust that you will respect your obligations and we will not hesitate to take legal action against you or any third party in case confidential information is divulged.

(Appellant Horsfall's Brief at 29.)

exception, especially in international commercial litigation involving sophisticated litigants and high stakes. In short, whether Gysler's actions can be attributed to "willfulness, bad faith, or fault" we feel is too close a question to justify a default judgment. *See United Coin*, 705 F.2d at 846 (" 'Any doubt should be resolved in favor of the petition to set aside the judgment so that cases may be decided on their merits. Since the interests of justice are best served by a trial on the merits, only after a careful study of all relevant considerations should courts refuse to open default judgments.' ") (citations omitted). In reaching this conclusion, we pass no judgment on whether *some* sanction may have been in order; we hold only that the ultimate sanction was not.

The magnitude of Judge Battisti's damages award only compound the inappropriateness of his action. *See Amernational Indus., Inc. v. Action-Tungsram, Inc.*, 925 F.2d 970, 978 (6th Cir.) ("Our conclusion [to vacate the default judgment] is further strengthened by the sheer size [approximately $11 million] of the damage award in this case."), *cert. denied*, 111 S. Ct. 2857 (1991); *Hester Int'l Corp. v. Federal Republic of Nigeria*, 879 F.2d 170, 175 (5th Cir. 1989) ("We have recognized previously that if the amount of money involved [in the judgment] is very great the amount militates in favor of granting a full trial on the merits."). Stated simply, awarding a default judgment for nearly $12 million on an action that GES, itself, originally valued at a fraction of that sum constitutes an excessively harsh, even draconian penalty under the facts

presented.[17] By setting aside the court's judgment, however, we do not mean to approve of any of the machinations undertaken to this point in the proceedings. In fact, we admonish the parties that further discovery abuses will be judged not on a clean slate, but in light of all prior abuses that already have occurred. Our decision to vacate, therefore, should not preclude the district court from considering whether lesser sanctions still should be imposed, or from reconsidering, in the event of subsequent abuses, whether a default judgment may yet be warranted.

We also set aside Judge Battisti's award of attorneys' fees against defendants. In this regard, we express skepticism as to whether the judge would have ordered this sanction without having entered a default judgment; if, as we suspect, he would not have done so, our decision to vacate the latter necessarily nullifies the former. Even assuming, however, that the award of attorneys' fees constitutes an independent sanction (*i.e.*, one that is not affected by our ruling on the default judgment), it still could not be sustained. As the Fifth Circuit has explained, under Rule 37(b)(2)(E), "a party may be personally liable for *reasonable* expenses including attorney's fees *caused* by the failure to comply with a discovery order." *Batson v. Neal Spelce Assocs., Inc.*, 765 F.2d 511, 516 (5th Cir. 1985) (citing *Roadway Express, Inc. v. Piper*, 447 U.S. 752, 763 (1980)); *see also Toth v. Trans World Airlines, Inc.*, 862 F.2d

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[17] In its complaint, GES prayed for pre-trebled "[a]ctual damages of at least $41,214.50 and such further damages as the evidence may show[.]" (App. 59.) GES did, however, seek punitive damages in excess of $10 million.

1381, 1386 (9th Cir. 1988) ("Because the costs and fees awarded were not properly segregated to those expenses caused by the failure to obey court orders, as circumscribed by 37(b)(2) and the district court's sanction order, we remand to the district court with directions to adjust the award of monetary sanctions accordingly.").

Here, the district judge justified the award of attorneys' fees in the following manner:

> GES and its counsel have itemized [GES's] expenses and attorney fees. Their rates are reasonable for the level of skill and experience of Plaintiff's counsel and considering complex issues raised by RICO and several issues of foreign law raised by the Defendants. Accordingly, $268,284.64 in fees and costs are assessed jointly and severally against Defendants and their counsel. . . .

800 F. Supp. at 1506. As such, the judge made no effort to discern the fees and expenses GES incurred solely as a result of defendants' and defense counsel's obstructive practices. *See Toth*, 862 F.2d at 1386 ("On remand, the district court is instructed to set forth facts explaining its ultimate award."); *Batson*, 765 F.2d at 517 ("[T]he court must articulate reasons for its assessment so that, if appealed, we may have a basis to review the court's action."). Absent such a determination, the attorneys' fees award cannot be sustained.

We thus vacate the default judgment as well as the award of attorneys' fees against defendants and remand with the following instructions, First, we instruct that the case be removed from Judge Battisti's docket and assigned to a different district judge. While we do not

share defendants' view that either Judge Battisti, by seeking reassignment to this case after disqualifying himself, or Judge Lambros, by granting the request, necessarily violated 28 U.S.C. § 455(a)[18] and Rule 7.09(1) of Local Rules for the Northern District of Ohio,[19] we do feel that, given the history of this litigation, the more appropriate course is to have a judge other than Judge Battisti assume control over the case from this point forward. In addition, we leave to the district court on remand the task of evaluating the appropriateness of the injunctive relief afforded GES by Judge Battisti.

III. GES'S CROSS-APPEAL

The following paragraphs of Judge Battisti's March 10, 1992, order explain his initial decision to sanction defense counsel with attorneys' fees and expenses:[20]

> 34. Counsel for Defendants are just as culpable [as defendants themselves]. They to have displayed a willingness to frustrate and obstruct court orders.
>
> 35. Counsel continued to rely on Swiss discovery procedures to object to deposition questions, interrogatories and document

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[18] This provision states: "Any justice, judge, or magistrate of the United States shall disqualify himself in any proceeding in which his impartiality might reasonably be questioned."

[19] This rule requires that a disqualified judge be replaced with one chosen by random lot.

[20] Judge Battisti cited two separate sources of authority for this action: Rule 37 and the Supreme Court's decision in *Chambers v. NASCO, Inc.*, 111 S.Ct. 2123 (1991) (discussing inherent power of the court to punish bad faith abuse of process).

requests, despite the September Order rejecting the applicability of Swiss discovery procedures to this case. Counsel's persistence in resisting discovery on the basis of Defendants' immunity under Swiss law delayed the production of documents and gave Defendants the opportunity to destroy documents.

36. Counsel advised their clients that the May Order was not applicable to Defendants' competition with GES so long as Defendants compete behind the mask of Biosphere, a point never refuted by counsel despite the opportunity. Since Defendants are virtually the sole officers, shareholders and employees of Biosphere, counsel's advice is highly contemptuous of this Court's rulings and perpetuates the Defendants' efforts to avoid liability through shell corporations.

37. Additionally, in filing Document A7077 under seal and withholding it from Plaintiff, defense counsel represented that the trade secrets issue could be decided on the basis of the contents of Document A7077. At the hearing on November 26, 1991, defense counsel attempted to minimize the significance of Document A7077 and its predecessors. The willingness of defense counsel to manipulate and fabricate facts to sustain whatever their current position might be is evidence of their bad faith.

38. Defense counsel's behavior even after the November 26, 1991 hearing demonstrates bad faith. Although counsel was in receipt of the alleged predecessors to Document A7077 on December 2, 1991 defense counsel did not make those documents available to Plaintiff or advise Plaintiff of the existence of such documents

until 5:43 P.M. on Friday, December 6, 1991. Furthermore, defense counsel did not advise Plaintiff's counsel of the nature of such documents.

39. Counsel's assistance in obstructing discovery is particularly offensive given the fact that defense counsel represented Defendants and reviewed the documents whereby Biosys terminated its contract with GES in May 1990. Had defense counsel just been retained for this lawsuit their claims of good faith might have had more credence. However, because defense counsel were involved at the outset of the alleged scheme, well before the complaint was ever field, they had every opportunity to assure timely discovery and the preservation of records. Instead, defense counsel has, at every opportunity, resorted to whatever tactic is accommodative to delay this case, including attempts to trivialize Defendants' destruction of discoverable records.

40. Defense counsel's principal response to questions about Defendants' failure to provide discovery has been to claim that Plaintiff has no case on the merits. Counsel should be well aware that perceived weaknesses in an opponent's case are no justification for repeated violations of court orders.

141 F.R.D. at 455-56.

Soon after Judge Battisti entered his order, defense counsel, comprised of Stephen Walters, Jason C. Blackford, and Thomas C. Buford, moved to alter or amend the judgment. Accompanying their motion were several affidavits that purported to refute several of the findings

made by Judge Battisti particularly those listed in paragraphs 35-39 of his March 10 order. For instance, an affidavit of Blackford taken June 4, 1992, was offered to demonstrate that defense counsel did not, in fact, continue to rely on the Swiss Penal Code Objection after the court's September 14 order (paragraph 35). A separate Blackford affidavit, dated June 26, 1992, also disputed the judge's finding that defense counsel had advised their clients that they could continue to compete with GES, despite the judge's express holdings indicating otherwise (paragraph 36). As to the judge's conclusion regarding defense counsel's handling of A7077 and its predecessors, additional affidavits asserted that defendants, not their counsel, were primarily responsible for the obstruction of the discovery process that occurred (paragraphs 37 and 38).

Despite having chastised defense counsel for their conduct, Judge Battisti nevertheless granted their motion. In doing so, however, he did not exactly heap praise on defense counsel:

> While the "factual" representations and arguments of law made by or on behalf of the attorneys leave much to be desired, the Court has reconsidered its decision to hold them jointly liable for all of Plaintiff's attorneys fees. As egregious and sanctionable as their conduct was, the Court nonetheless, on reconsideration of the exercise of its discretion, has decided to vacate the part of its March 10, 1992 Order holding them jointly and severally liable for all of Plaintiff's attorney fees. Defendants, the principal culprits, remain liable for Plaintiff's damages and attorneys fees.

(App. 2660-61.)

GES now contends that Judge Battist erred by retracting his previous decision to sanction defense counsel. Rule 37 states that, if a party fails to obey a discovery order, "the court in which the action is pending may make such orders in regard to the failure as are just." Fed. R. Civ. P. 37(b)(2); *see also Metrocorps, Inc. v Eastern Massachusetts Junior Drum & Bugle Corps Ass'n*, 912 F.2d 1, 2 (1st Cir. 1990). Rule 37 also provides that:

> In lieu of any order or in addition thereto, the court shall require the party failing to act or the attorney advising that party or both to pay the reasonable expenses, including attorney's fees, caused by the failure unless the court finds that the failure was substantially justified or that other circumstances make an award of expenses unjust.

Fed. R. Civ. P. 37(d). The notes on the rule add that:

> Subdivision (b)(2) is amplified to provide for payment of reasonable expenses caused by the failure to obey the order. . . . The provision places the burden on the disobedient party to avoid expenses by showing that his failure is justified or that special circumstances make an award of expenses unjust. Allocating the burden in this way conforms to the changed provisions as to expenses in Rule 37(a), and is particularly appropriate when a court order is disobeyed.

Fed. R. Civ. P. 37(b)(2) advisory committee's note (citations omitted).

GES argues that, under Rule 37, Judge Battisti effectively had no choice but to sanction defense counsel; his ultimate failure to do so, it is urged, constitutes an abuse of discretion. As GES observes, to find support for its

argument this court need look no further than Judge Battisti's order granting defense counsel's motion to amend the judgment; after all, the judge granted the requested relief while simultaneously characterizing defense counsel's conduct as "egregious and sanctionable." Judge Battisti's doublespeak aside, GES asserts that there are other reasons justifying the imposition of sanctions against defense counsel. Not only did defense counsel withhold A7077 from GES until it became clear that their reliance on Swiss law was indefensible, but also they "deliberately chose to present no defense to the motion for sanctions as a litigation strategy." (Cross-Appellant's Brief at 42.) Sanctioning defense counsel, according to GES, would also promote the venerable goals of enhancing the public's perception of attorneys and judges and deterring other litigants from similarly abusing the discovery process.

Perhaps GES's arguments would be determinative were we merely reviewing Judge Battisti's initial decision to award sanctions. GES's task is not so easy, however, where, as here, it must persuade the court that an abuse of discretion has occurred. Indeed, in view of the affidavits submitted by defense counsel, we cannot conclude that this is an occasion in which a reversal of Judge Battisti's decision not to sanction is in order. Even if we were to subscribe to GES's view that Judge Battisti rejected defense counsel's post-judgment evidence, the question would still remain whether, at the time he issued his judgment, Judge Battisti could have justifiably

reached the opposite conclusion.[21] We feel that he could have, and accordingly, we reject GES's argument founded on Rule 37.

GES also contends that Rule 59(e) establishes a separate basis for reversing the court's decision not to sanction defense counsel. Rule 59(e) provides that "[a] motion to alter or amend the judgment shall be served not later than 10 days after entry of the judgment." At issue here is not whether defense counsel filed their motion in a timely manner, but instead, whether Rule 59(e) is an appropriate vehicle through which to secure the relief sought. GES argues that defense counsel could not properly invoke the rule in this instance because they failed to offer their arguments and evidence prior to judgment.[22] Defense

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[21] By the same token – without suggesting that Judge Battisti's characterization of defense counsel's conduct is accurate – to determine that conduct is "sanctionable" is not to definitively resolve that sanctions must necessarily follow. To take the final step of actually imposing sanctions requires the exercise of discretion, only the abuse of which will cause this court to set aside the lower court's ruling.

[22] Defense counsel's initial response to GES, contained in their supplemental memorandum filed with the district court on the morning of the hearing on GES's renewed motion for sanctions, was as follows:

> Plaintiff in its Supplemental Memorandum hurls invective and insult against the Defendants (e.g. – "plotting with Swiss counsel" p. 14; "fleeing to Switzerland" p. 12). Beyond the jingoistic notion permeating the Supplemental Memorandum that "Swiss" – "criminal", Plaintiff also attempts to drive a wedge between the Defendants and their counsel.
>
> The Court will note that there is absolutely no evidence offered by Plaintiff of wrong-doing or

counsel's belief that they would have compromised their clients' position by mounting a defense of their own is, for GES, unavailing. GES cites case law and various ethical rules to support its claim that defense counsel should have responded to the accusations against them from the outset, instead of waiting until the judgment already had been rendered.

Although we agree in the abstract that counsel may not first encourage their clients to obstruct discovery and then use those clients to shield themselves from discovery sanctions, we do not feel that this scenario accurately depicts what occurred in this particular case. Here, defense counsel obtained GES's supplemental memorandum in support of its renewed motion for sanctions only one day before the hearing on the motion was to take place. This memorandum alleged that defendants had destroyed documents and that defense counsel had, themselves, either condoned or participated in obstructive discovery tactics. Thus, both practical – *i.e.*, the need to respond expeditiously – and ethical – *i.e.*, the duty to zealously represent their clients – considerations factored into defense counsel's decision not to pursue their defense at that time. Viewed from this perspective, defense counsel did not act improperly by opting to focus, at least initially, on the arguments supporting their clients' position. We therefore reject GES's assertion that,

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impropriety on the part of defense counsel. If Plaintiff purports to have such evidence, let it come forward now or forever stop this slander.

(App. 1717.)

pursuant to Rule 59(e), Judge Battisti abused his discretion by reconsidering his earlier decision to sanction defense counsel.[23] *See Healey v. Chelsea Resources, Ltd.*, 947 F.2d 611, 623 (2d Cir. 1991) ("A potential for conflict is inherent in a sanctions motion that is directed against both a client and a lawyer. . . . ") (citing *in re Ruben*, 825 F.2d 977, 985 (6th Cir. 1987), *cert. denied*, 485 U.S. 934 (1988)).

We **VACATE** the default judgment and **REMAND** for proceedings consistent with this opinion. As to plaintiff's cross-appeal, we **AFFIRM** the denial of sanctions.

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[23] Here, we reiterate our point that Judge Battisti failed to determine the amount of GES's attorneys' fees and costs directly attributable to defendants' and defense counsel's failure to obey court orders. Thus, even if we were to conclude that the trial judge erred by ultimately deciding against sanctioning defense counsel, we still would be compelled to vacate his attorneys' fees award.

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

GENERAL ENVIRONMENTAL SCIENCE CORPORATION Plaintiff, -vs- FRANK L. HORSFALL, et al., Defendants.	)	1:90 CV 1340 **ORDER** (Filed Sep. 14, 1990)

Battisti, J.

Before the court are the Defendants' Combined Motion to Strike Subpoena and Notice of Deposition and for Protective Order (the "August 13 Motion") and the Motion for Defendant Frank L. Horsfall for a Protective Order (the "August 24 Motion"). For the reasons stated herein the former is GRANTED IN PART and the latter is DENIED.

Defendants' concern in the August 13 Motion is the disclosure of the identities and addresses of Defendant Biosys' customers. Defendants fear that Plaintiff seeks this information for business, rather than litigation, purposes. They, therefore, request the court to grant a protective order under Fed. R. Civ. P. 26(c) prohibiting any inquiry into the identity and location of Biosys' customers.

Where confidential information is involved, "[i]n most cases the key issue is not whether the information will be disclosed but under what conditions. The need for

the information is held paramount but reasonable protective measures are supplied to minimize the effect on the party making the disclosure." 8 C. Wright & A. Miller, Federal Practice and Procedure §2043 (1970).

Federal courts have recognized the discoverability of customer information with proper safeguards. *See, e.g., Chesa Int'l, Ltd. v. Fashion Associates, Inc.*, 425 F. Supp. 234, 237 (S.D.N.Y. 1977) (holding that "[u]nder a protective order, the names of customers is a proper subject for discovery"), *aff'd mem.*, 573 F.2d 1288 (1977); *La Chemise Lacoste v. General Mills, Inc.*, 53 F.R.D. 596, 605 (D. Del. 1971) (compelling discovery of the names of customers with an appropriate provision protecting the Plaintiff), *aff'd on other grounds*, 487 F.2d 312 (1972).

The court does not prohibit inquiry into the identities and locations of Biosys' customers, but any such information derived may be used by Plaintiff solely for the purposes of this action and may not be used for any other purpose, including, without limitation, any competitive purpose.

In the August 24 Motion Defendant Frank L. Horsfall seeks a protective order staying his deposition until such time as the court decides upon the Defendant's motion to apply Swiss law. Defendant also cites Article 273 of the Swiss Penal Code as an additional basis for a protective order.

Defendant's first ground for relief is nothing more than slight [sic] of hand. Even if Swiss law were applied in construing the Distribution Agreement between the parties, it hardly requires the court to grapple with the difficulties of Swiss discovery procedures, as Defendant's

brief suggests. The absence of private deposition procedures in Switzerland is of no account in this instance as Defendant is under United States' procedural law, and according to his motion to apply Swiss law is still physically present in the United States.

With regard to Defendant's second ground for a protective order, Plaintiff properly points out the inapplicability of Article 273 of the Swiss Penal Code in this instance. Defendant has failed to demonstrate any Swiss or third party interest in secrecy, and the Swiss government has indicated that where such an interest is lacking, a party may disclose manufacturing or business secrets without violating Article 273. *See, e.g., Roberts v. Heim,* 130 F.R.D. 430, 436 (N.D. Cal. 1990) (stating that "[t]he teaching of the Swiss Attorney General . . . is that Article 273 does not prohibit a person from divulging his own business affairs but only from divulging the business affairs of others without their consent").

In addition, the Defendant's reliance on *Societe Internationale Pour Participations Industrielles et Commerciales, S.A. v. Rogers,* 357 U.S. 197 (1958), is misplaced. In the *Societe Internationale* case, the Swiss Federal Attorney had determined that disclosure of the information would violate Swiss law and had issued an order enjoining its release. Defendant has failed to show that similar circumstances exist in this case.

The court sees no reason why this deposition should not go forward. Defendant's broad allegations of possible prejudice are insufficient. Accordingly, the August 24

Motion for a protective order is DENIED, and the August 13 Motion is GRANTED to the extent provided herein.[1]

IT IS SO ORDERED.

/s/ Frank J. Battisti
Frank J. Battisti
United States District Judge

[1] Due to the cancellation of Denny White's initial deposition date, Defendants' timeliness objection need not be addressed, and therefore, Defendants' Motion to Strike Subpoena and Notice of Deposition is DENIED.

[Published and Cited as 753 F. Supp. 664
(N.D. Ohio 1990)]

GENERAL ENVIRONMENTAL SCIENCE CORP.,
Plaintiff,

v.

Frank L. HORSFALL, et al.,
Defendants.

No. 1:90 CV 1340.

United States District Court,
N.D. Ohio, E.D.

Dec. 12, 1990.

Ohio corporation brought RICO and state tort suit against Swiss corporation, Swiss residents and others. On motions to dismiss and to apply law of Switzerland, the District Court, Battisti, J., held that: (1) Ohio corporation was not bound by forum selection clause contained in contract with Swiss corporation where claims did not arise directly from contract; (2) personal jurisdiction could be asserted over Swiss defendants pursuant to Ohio long-arm statute and due process clause; (3) service in Switzerland by means of letters rogatory was authorized; (4) action was properly venued; (5) forum non conveniens did not require dismissal of action; and (6) choice of law provision in party's contract required application of Swiss law to interpretation and determination of validity of that contract, but not to other issues raised in case.

Ordered accordingly.

Jerome F. Weiss, Richard L. Stoper, Jr., and Niki Z. Schwartz, Cleveland, Ohio, for plaintiff.

Thomas C. Buford and Jason C. Blackford, Cleveland, Ohio, for defendants.

ORDER

BATTISTI, District Judge.

Before the court is Defendants Biosys Corporation ("Biosys") and Gustavo Gysler's multi-pronged motion to dismiss the instant action, and Defendant Frank L. Horsfall's motion to apply the law of Switzerland. For the reasons stated herein, the motion to dismiss is DENIED, and the motion to apply the law of Switzerland is GRANTED IN PART and DENIED IN PART.

I. FACTS

On July 27, 1990, Plaintiff, General Environmental Science Corporation ("GES"), filed an eighteen count complaint against Defendants Biosys, Gysler, Horsfall, and John L. Strauss (collectively the "Defendats"). GES is an Ohio corporation engaged in the manufacture, distribution and sale of micro-biological products used for bacterial augmentation in waste water treatment and aqua culture. In essence, the complaint alleges that the defendants carried out a pattern of fraudulent activity with the intent of entering into competition with GES. This fraudulent activity allegedly included the theft and use of GES trade secrets to initiate the manufacture, sale and distribution of products in direct competition with GES products.

According to the complaint, prior to November 22, 1989, both Horstall and Strauss were under contract with

GES. Strauss is a resident of Virginia, and Horsfall is alleged to be a resident of Ohio.

On December 17, 1987, Strauss and GES signed a contract granting Strauss the exclusive right to sell GES products in Europe and the Middle East (the "Strauss Agreement"). By its terms the Strauss Agreement was valid until terminated by one of the parties. In addition, it stated that "[Strauss] must not utilize or pass on to any third person either any trade or business secret of any other confidential information which has become known to him in any way during the period of this AGREEMENT." It also stated that "[Strauss] agrees in particular and explicitly not to represent, market, sell or distribute products other than those manufactured and/or sold by [GES] which are identical or similar to the PRODUCTS; or to participate directly or indirectly in any way whatsoever in any company competitive to [GES]."

On May 19, 1989, GES and Horsfall entered into a contract providing that Horsfall would work as a consultant to GES in the area of micro-biology (the "Horsfall Agreement"). The Horsfall Agreement stated that "[Horsfall] agrees to preserve [GES's] trade secrets, and will not reveal or use any such trade secret for the benefit of himself or a third party without [GES's] written consent." In addition, it stated that "[Horsfall] agrees that while this contract remains in force and for one year thereafter, he will not, for the benefit of himself or another, in any capacity, and without the prior written consent of [GES], engage anywhere in the world in the development, manufacture or marketing of bacterial cultures intended for sale as bacterial augmentation

products for use in wastewater treatment or aquaculture in direct competition with products made by [GES]."

On or about November 22, 1989, GES entered into a contract with Biosys, then operating under the name of X-O Corporation (the "X-O Contract"). Biosys is alleged to be a business entity organized under the laws of Switzerland, with its headquarters in Rolle, Switzerland. The X-O Contract provided that X-O would be the exclusive distributor of GES products in Europe. It further provided that Horsfall and Strauss would become employees of X-O, and that accordingly, they would be released from their contracts with GES. Finally, Section Ten of the X-O Contract stated:

> This Agreement shall be governed by the laws of Switzerland and the place of court is Rolle Switzerland in case of claims from [GES]. In the case of claims by [Biosys], this Agreement shall be governed by the laws of the State of Ohio and the federal laws of the United States of America as applied by the United States Federal Courts in the State of Ohio.

Plaintiff's complaint alleges that this contract was part of defendants' fraudulent scheme. Specifically, the complaint alleges that the defendants have violated the Racketeer Influenced Corrupt Organization Act, 18 U.S.C. § 1961 et seq., and committed numerous torts under the laws of the State of Ohio.[1] The complaint does not raise

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[1] Specifically, the Plaintiff has made the following claims:
– Counts I-IV are based upon RICO.
– Counts V and VI allege that Strauss and Horsfall, respectively, violated the Strauss Agreement and the Horsfall Agreement, respectively. Plaintiff claims that

any claims based upon the alleged breach of the X-O Contract.

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since the X-O Agreement was fraudulently entered into, and therefore, a nullity, Strauss and Horsfall remained bound by their prior contracts with the Plaintiff.

– Count VII alleges that the Defendants violated Ohio Rev.Code Ann. § 1333.51(B) & (C) and Ohio common law by engaging in the conversion of trade secrets.

– Counts VIII and XI allege that Strauss and Horsfall, respectively, breached the non-compete clauses of the Strauss Agreement and the Horsfall Agreement, respectively.

– Count X alleges that Biosys and Gysler violated Ohio common law by tortiously interfering with the contractual relationships of GES with Strauss and Horsfall.

– Count XI alleges that the Defendants violated Ohio Rev.Code Ann. § 2923.32(A)(1) by conducting or participating in, or conspiring to conduct or participate in a pattern of corrupt activity.

– Count XII alleges that the Defendants violated Ohio Rev.Code Ann. § 2923.32(A)(3) by knowingly receiving the proceeds derived from a pattern of corrupt activity.

– Count XIII seeks a temporary restraining order enjoining Strauss and Horsfall from selling, transferring or disposing of any of their interests in property, pursuant to Ohio Rev.Code Ann. § 2923.34(E).

– Count XIV seeks payment by Biosys of the reasonable value of GES products provided to Biosys for which payment has not been received.

– Count XV alleges that the Defendants have published false and defamatory statements about the Plaintiff's products, production techniques and management.

– Count XVI alleges that the Defendants have tortiously interfered with the Plaintiff's contractual relationships with its customers.

– Count XVII alleges that due to the presence of malice, aggravated or egregious fraud, oppression or insult in

II. DEFENDANTS BIOSYS AND GYSLER'S MOTION TO DISMISS

On September 5, 1990, Defendants Biosys and Gysler (referred to collectively as the "Swiss Defendants"),[2] moved to be dismissed from this action for lack of jurisdiction, improper venue, insufficiency of service of process, and forum non conveniens.

A. Forum Selection Clause

The Swiss Defendants claim that Plaintiff is bound by the X-O Contract's forum selection clause, and that, therefore, this suit must be dismissed.

As the Swiss Defendants note, it has long been established that in a diversity suit a federal court must apply the conflict of laws rules prevailing in the state in which it is located. *Klaxon Co. v. Stentor Elec. Mfg.*, 313 U.S. 487, 496, 61 S.Ct. 1020, 1021, 85 L.Ed. 1477 (1941). Were this a simple contract action, cognizable within the court's diversity jurisdiction, the court would look to Ohio conflict of laws rules to determine whether a choice of forum provision could be enforced.

In the instant case, however, the Plaintiff claims violations of the federal RICO statute, state statutes and state

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the Defendants' conduct, punitive damages are appropriate in this case.

– Count XVIII alleges that the Defendants were negligent in failing to immediately advise the Plaintiff of the alleged defects in its products.

[2] Gysler is alleged to be the President of Biosys and a citizen and resident of Switzerland.

common law. No contractual claims are made and no contract remedies sought. Plaintiff is entitled to try this case under its chosen theory. Accordingly, this court will not treat the instant action as arising out of the X-O Contract. Instead, it will be deemed to have arisen out of the Plaintiff's ongoing business relationships with the Defendants. The X-O Contract is merely one of the final manifestations of those relationships, and as such, its terms cannot limit a comprehensive challenge to the Defendants' entire courses of conduct in this forum.

This suit is, therefore, broader than the forum selection clause. *See Farmland Industries, Inc. v. Frazier-Parrott Commodities, Inc.*, 806 F.2d 848, 852 (8th Cir. 1986). As Plaintiff's claims do not arise directly from the X-O Contract, Plaintiff could not have foreseen being bound by its forum selection clause in bringing these claims. At the most, the Defendants' actions with regard to the X-O Contract may be claimed as predicate acts to the establishment of some of Plaintiff's other claims.[3] Accordingly, Plaintiff's choice of forum prevails unless the Swiss Defendants can establish another reason for dismissal.

B. Personal Jurisdiction

The Swiss Defendants move pursuant to Fed.R.Civ.P. 12(b)(2) to dismiss the claims against them due to this court's lack of personal jurisdiction. The exercise of personal jurisdiction over the Swiss Defendants is alleged to

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[3] For instance, to prove that Strauss and Horsfall have violated their contracts with GES, the Plaintiff must prove that the X-O Contract is a nullity.

be improper because the requirements of the Ohio long-arm statute have not been met, and because the exercise of jurisdiction does not comport with the requirements of due process.

The Supreme Court examined the prerequisites to a federal court's exercise of jurisdiction in *Omni Capital, Int'l. v. Rudolf Wolff & Co.*, 484 U.S. 97, 108 S.Ct. 404, 98 L.Ed.2d 415 (1987). The *Omni* Court held:

> Before a federal court may exercise personal jurisdiction over a defendant, the procedural requirement of service of summons must be satisfied. "[S]ervice of summons is the procedure by which a court having venue and jurisdiction of the subject matter of the suit asserts jurisdiction over the person of the party served." *Mississippi Publishing Corp. v. Murphree*, 326 U.S. 438, 444-45 [66 S.Ct. 242, 245-46, 90 L.Ed. 185] (1946). Thus, before a court may exercise personal jurisdiction over a defendant, there must be more than notice to the defendant and a constitutionally sufficient relationship between the defendant and the forum. There also must be a basis for the defendant's amenability to service of summons.

484 U.S. at 104, 108 S.Ct. at 409. The Court further noted that "[t]oday, service of process in a federal action is covered generally by Rule 4 of the Federal Rules of Civil Procedure." *Id.*

Rule 4(f) describes the territorial limits of effective service.[4] Specifically, it authorizes service anywhere in

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[4] Rule 4(f) provides:

All process other than a subpoena may be served anywhere within the territorial limits of the state in which the district court is held, and, when authorized

the state in which the district court sits and anywhere otherwise authorized by federal statute or by the Federal Rules of Civil Procedure. The Plaintiff does not seriously dispute the Swiss Defendants' assertion that 18 U.S.C. § 1965(d) authorizes nationwide service of process, *see, e.g., Rolls-Royce Motors, Inc. v. Charles Schmitt & Co.*, 657 F.Supp. 1040, 1055 (S.D.N.Y.1987), but does not provide for international service. *See, e.g., Michelson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 709 F.Supp. 1279, 1285 (S.D.N.Y.1989). Accordingly, the court will assume without deciding that in the instant matter § 1965(d) does not authorize service. *See also Shaw v. Rolex Watch U.S.A., Inc.*, 745 F.Supp. 982, 987 (S.D.N.Y.1990).

Plaintiff asserts, however, that service is authorized by Rule 4(e). The second sentence of Rule 4(e) provides for service on out-of-state defendants by the means prescribed in state statutes or rules.[5] A federal court, therefore, may look "to the long-arm statute of the State in which it sits to determine whether a defendant is amenable to service. . . . " *Omni*, 484 U.S. at 105, 108 S.Ct. at 410.

The Ohio long-arm statute is found in Section 2307.382 Ohio Rev.Code Ann. (Anderson 1981 & Supp.1989). "Th[e] statute confers on the district court the ability to exercise

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by a statute of the United States or by these rules, beyond the territorial limits of that state.

[5] Rule 4(c) provides:

. . . Whenever a statute or rule of court of the state in which the district court is held provides (1) for service of a summons . . . upon a party not an inhabitant of or found within the state . . . service may . . . be made under the circumstances and in the manner prescribed in the statute or the rule.

specific or limited personal jurisdiction over a nonresident defendant where the cause of action arises out of an act or acts creating one of several designated relationships." *Creech v. Roberts*, 908 F.2d 75, 79 (6th Cir.1990).

The Plaintiff relies primarily upon § 2307.382(A)(1), which provides that "[a] court may exercise personal jurisdiction over a person who acts directly or by an agent, as to a cause of action arising from the person's: (1) Transacting any business in this state;. . . . " "[I]t is a settled proposition of Ohio law that [the scope of § 2307.382(A)(1)] was intended to extend to the constitutional limits of due process. . . . " *Creech*, 908 F.2d at 79 (citing *In-Flight Devices Corp. v. Van Dusen Air, Inc.*, 466 F.2d 220, 224-25 (6th Cir. 1972)). The relevant inquiry, therefore, is whether, within the bounds of due process, Biosys and Gysler can be found to have transacted business in Ohio. *Id.*

The United States Court of Appeals for the Sixth Circuit has provided three criteria to be used in determining whether the exercise of jurisdiction comports with due process. They are:

> First, the defendant must purposely avail himself of the privilege of acting in the forum state or causing a consequence in the forum state. Second, the cause of action must arise from the defendant's activities there. Finally, the acts of the defendant or consequences must have a substantial enough connection with the forum state to make the exercise of jurisdiction over the defendant reasonable.

LAK, Inc. v. Deer Creek Enters., 885 F.2d 1293, 1299 (6th Cir.1989) (quoting *Southern Mach. Co. v. Mohasco Indus.*,

401 F.2d 374, 381 (6th Cir.1968)), *cert. denied*, ___ U.S. ___, 110 S.Ct. 1525, 108 L.Ed.2d 764 (1990).[6]

In addition, in *Serras v. First Tenn. Bank Nat. Ass'n*, 875 F.2d 1212, 1214 (6th Cir.1989), the Sixth Circuit delineated the "settled procedural scheme to guide trial courts" in examining challenges to jurisdiction. The court stated that the plaintiff's "burden is merely that of making a *prima facie* showing that personal jurisdiction exists." *Id.* If that burden is met "the motion to dismiss should be denied, 'notwithstanding any controverting presentation by the moving party.' " *Id.* (quoting *Marine Midland Bank, N.A. v. Miller*, 664 F.2d 899, 904 (2nd Cir.1981)). The court specifically noted its concern lest "the door to a federal courtroom . . . be slammed in the face of a plaintiff seeking to invoke it's powers where there is, in fact, no defect in personal jurisdiction." *Id.* at 1215.

Accordingly, the court has considered the written submissions of the parties in the instant matter to determine whether the Plaintiff has made a prima facie showing of the Swiss Defendants' amenability to service.[7] In

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[6] The test provided in *Southern Machine Co. v. Mohasco Indus.*, 401 F.2d 374 (6th Cir.1968) is a crystallization of the Sixth Circuit's cases applying *International Shoe Co. v. State of Washington*, 326 U.S. 310, 316, 66 S.Ct. 154, 158, 90 L.Ed. 95 (1945) (requiring that the defendant have "certain minimum contacts with [the forum] such that the maintenance of the suit does not offend 'traditional notions of fair play and substantial justice.' ") (quoting *Milliken v. Meyer*, 311 U.S. 457, 463, 61 S.Ct. 339, 343, 85 L.Ed. 278 (1940)).

[7] It is well established that "each defendants' contacts with the forum must be assessed individually." *Calder v. Jones*, 465 U.S. 783, 790, 104 S.Ct. 1482, 1487, 79 L.Ed.2d 804 (1984).

doing so, the pleadings and affidavits were considered "in the light most favorable to the plaintiff." *Id.* at 1214 (citing *Welsh v. Gibbs*, 631 F.2d 436, 439 (6th Cir.1980), *cert. denied*, 450 U.S. 981, 101 S.Ct. 1517, 67 L.Ed.2d 816 (1981)).

1. Purposeful Availment

The first and most important element of the *Mohasco Indus.* test is a determination whether the defendant purposely availed itself of the privilege of acting in the forum state or causing a consequence in the forum state. The Supreme Court has repeatedly emphasized the importance of this showing. *See, e.g., Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 475, 105 S.Ct. 2174, 2183, 85 L.Ed.2d 528 (1985) (stating that "[t]his 'purposeful availment' requirement ensures that a defendant will not be haled into a jurisdiction solely as a result of 'random,' 'fortuitous' or 'attenuated' contacts."); and *Asahi Metal Industry Co., Ltd. v. Superior Court*, 480 U.S. 102, 112, 107 S.Ct. 1026, 1032, 94 L.Ed.2d 92 (1987).

The Sixth Circuit confronted the question of purposeful availment in the context of interstate contractual relations in the *LAK* case. 885 F.2d at 1300. The court noted:

> There is a difference between what *World-Wide Volkswagen* [*Corp. v. Woodson*, 444 U.S. 286, 299 [100 S.Ct. 559, 568, 62 L.Ed.2d 490] (1980)] calls a mere "collateral relation to the forum State," . . . and the kind of substantial relationship with the forum state that invokes by design the "benefits and protections of its laws. [*Hanson v.*] *Denckla*, 357 U.S. [235, 253 [78 S.Ct. 1228, 1240, 2 L.Ed.2d 1283] (1958)]. . . . The Supreme Court

> has emphasized, with respect to interstate contractual obligations, that "parties who 'reach out beyond one state and create continuing relationships and obligations with citizens of another state' are subject to regulation and sanctions in the other State for the consequences of their activities." *Burger King*, 471 U.S. at 473, 105 S.Ct. at 2182.

Id.

The Plaintiff has made the required prima facie showing that each of the Swiss Defendants has reached out and created continuing relationships with citizens of the state of Ohio. Biosys entered into two contracts with GES. The latter of these contracts was the X-O Contract which Gysler signed and allegedly negotiated, Gysler in his affidavit confirms that he travelled to Cleveland on October 16, 1989 to meet with the President of GES. This was just over a month before the X-O Contract was signed. *See* Affidavit of Gustavo Gysler, taken 9/5/90, affixed as exhibit to Defendants' Biosys Corporation and Gustavo Gysler Motion to Dismiss [hereinafter Motion to Dismiss].

The Plaintiff also alleges that Biosys Corporation maintained an agent, Horsfall, in Cleveland, and that he transacted business and communicated frequently with Biosys, Gysler, and Strauss. This is supported by the excerpts of Horsfall's deposition which were submitted by Plaintiff. *See* Plaintiff's Memorandum in Opposition to Defendants' Biosys Corporation and Gustavo Gysler Motion to Dismiss [hereinafter Plaintiff's Memorandum in Opposition to Motion to Dismiss], Exhibit A. *See also* Plaintiff's Supplemental Memorandum in Opposition to

Defendants Biosys Corporation and Gustavo Gysler Motion to dismiss [hereinafter Plaintiff's Supplemental Memorandum in Opposition], Exhibit C (telephone records of Horsfall). In addition, Plaintiff alleges that Biosys had GES products picked up in Cleveland by its agent Panalpina. Biosys has not disputed this.

Both Biosys and Gysler are alleged to have had extensive contact with GES. The X-O Contract provides for Biosys to send orders and payments to GES in Cleveland. *See also* Plaintiff's Memorandum in Opposition to Motion to Dismiss, Exhibit C (orders submitted by Biosys).

In addition, there are the underlying allegations of this case. The Plaintiff alleges, in essence, that the Defendants sought to steal their trade secrets by fraudulently entering and subsequently repudiating the X-O Contract. Thus, there is an allegation that the Defendants have reached into Ohio to acquire the trade secrets of an Ohio corporation by fraud, deception or theft. The Plaintiff supports these assertions with the affidavit of Karl Ehrlich, the co-founder of a company which X-O, acting through its President, Gysler, sought to acquire. *See* Plaintiff's Memorandum in Opposition to Motion to Dismiss, Exhibit B, at 3 (stating that "[t]hey also indicated that they (X-O) were entering a contract for distribution with GES that they never intended to honor, and that they planned in the future to break this contract as soon as they could set up their own production facilities and that they would use product variability and potency as a basis for breaking the contract and competing."). A letter attempting to repudiate the X-O Contract on the grounds

of product variability was sent by Gysler to GES in Cleveland on May 4, 1990. *See* Plaintiff's Supplemental Brief in Opposition, Exhibit D (two letters from Gysler to GES dealing with the repudiation of the X-O Contract).

Finally, the terms of the X-O Contract itself support a finding that the Swiss Defendants have availed themselves of the benefits and protections of Ohio's laws. Claims arising from the contract could only be brought by X-O in the State of Ohio. Thus, the Swiss Defendants had availed themselves of Ohio law as their only protection against a breach of the contract by GES.

The evidence presented by the plaintiff make a prima facie showing that the Swiss Defendants contacts with the forum were more than merely random, fortuitous or attenuated. Instead, the evidence seems to indicate a considered and deliberate establishment of a relationship with an Ohio corporation through which substantial Biosys business was transacted. As Gysler appears from the evidence to be the "point man" on the Biosys end of these transactions, he has purposefully availed himself of the benefits of the forum as well.

2. Arising out of the Forum State

The second *Mohasco Indus.* element – that the cause of action arise from the defendant's forum state activities – is also sufficiently established by the Plaintiff. "An action will be deemed not to have arisen from the defendant's contacts with the forum state only when they are unrelated to the operative facts of the controversy." *Creech*, 908 F.2d at 80 (citing *Third Nat'l Bank in Nashville v. WEDGE Group Inc.*, 882 F.2d 1087, 1091 (6th Cir. 1989),

cert. denied, ___ U.S. ___, 110 S.Ct. 870, 107 L.Ed.2d 953 (1990)).

In *Serras*, 875 F.2d at 1213, the Michigan plaintiffs alleged that they bought a Tennessee restaurant in reliance upon the Tennessee defendant's fraudulent misrepresentations. Upon these facts, the court held that evidence of phone calls, mailings and a visit by the defendant's agent, considered along with the pleadings, were sufficient to support plaintiffs' allegation that the claim arose in Michigan. *Id.* at 1217-18.

The same can be said of the alleged fraudulent actions and evidence of contacts in the instant case. Based upon the evidence discussed in the prior section, the Plaintiff has succeeded in presenting a prima facie case.

3. Reasonableness

Finally, the third *Mohasco Indus.* factor requires the court to determine whether the exercise of jurisdiction over the Swiss Defendant's is reasonable. As the Sixth Circuit has noted, the third element is derived from the following statement in the *Burger King* case:

> [W]here a defendant who purposefully directed his activities at forum residents seeks to defeat jurisdiction, he must present a compelling case that the presence of some other considerations would render jurisdiction unreasonable. Most such considerations usually may be accommodated through means short of finding jurisdiction unconstitutional.

Creech, 908 F.2d at 80 (quoting *Burger King*, 471 U.S. at 477, 105 S.Ct. at 2184-85). The Sixth Circuit has also stated

that "[w]hen the first two elements [of the *Mohasco Indus.* test] are met, an inference arises that the third, fairness, is also present; only the unusual case will not meet this third criterion." *American Greetings Corp. v. Cohn*, 839 F.2d 1164, 1170 (6th Cir.1988) (quoting *First Nat'l Bank of Louisville v. J.W. Brewer Tire Co.*, 680 F.2d 1123, 1126 (6th Cir.1982)).

The Plaintiff has made a prima facie showing that the exercise of jurisdiction is reasonable in this case, and the Swiss Defendants have failed to present a compelling argument that other factors make such an exercise unreasonable. While the Swiss Defendant's face an elevated burden in defending this suit in the United States, it is not unbearable. In addition, inconvenience can be mitigated in some respects through agreements between the parties and intervention by the court where necessary. In light of the actions alleged, the interests of the plaintiff and the forum state favor the exercise of jurisdiction by this court. Finally, while the interests of Switzerland must be considered, it seems clear that they do not mandate the conclusion that the exercise of jurisdiction over the Swiss Defendants will violate principles of fair play and substantial justice.

Accordingly, the court finds that it may properly exercise personal jurisdiction over the Swiss Defendants pursuant to § 2307.382(A)(1) Ohio Rev.Code Ann. (Anderson 1981 & Supp.1989).

C. Service of Process

The Swiss Defendants move pursuant to Fed.R.Civ.P. 12(b)(5) to dismiss the claims against them due to the use

by the Plaintiff of an improper manner of service of process. They allege that the only appropriate manner of service in Switzerland is by means of letters rogatory. The Plaintiff had attempted to perfect service by means of both letters rogatory and certified mail with return-receipt requested. At the time of this motion only service by certified mail had arguably been perfected. This, however, is no longer the case.

On November 28, 1990, the United States Department of State forwarded the completed letters rogatory to this court. The Swiss Defendants have now been served by Swiss officials in accordance with Swiss law, and accordingly, the objection to the validity of service by certified mail is moot.

The court is still faced, however, with the propriety of the service by means of the letters rogatory under Fed.R.Civ.P. 4. Rule 4(i)(1) provides:

> When the federal or state law referred to in subdivision (e) of this rule authorizes service upon a party not an inhabitant or found within the state in which the district court is held, and service is to be effected upon the party in a foreign country, it is also sufficient if service of the summons and complaint is made: . . . (B) as directed by the foreign authority in response to a letter rogatory, when service . . . is reasonably calculated to give actual notice. . . .

As has been noted, *see supra* note 5, Rule 4(e) provides for service upon parties not inhabitants of the state in which the district court is held by means of that state's statutes or rules.

Plaintiff asserts that Ohio Rule of Civil Procedure 4.3 (Anderson 1982 & Supp.1989) authorizes service upon the Swiss Defendants as envisioned by Federal Rule 4(e). Ohio Rule 4.3 provides in pertinent part:

> Service of process may be made outside of this state, as provided herein, in any action in this state, upon a person who at the time of service of process is a nonresident of this state. . . . The term "person" includes an individual . . . or a corporation, . . . who, acting directly or by an agent, has caused an event to occur out of which the claim which is the subject of the complaint arose, from the person's:
>
> (1) Transacting business in this state:
>
> . . .
>
> (4) Causing tortious injury in this state by an act of omission outside this state if he regularly does or solicits business, or engages in any other persistent course of conduct or derives substantial revenue from goods used or consumed or services rendered in this state;
>
> . . .
>
> (9) Causing tortious injury in this state to any person by an act outside this state committed with the purpose of injuring persons, when he might reasonably have expected that some person would be injured thereby in this state;
>
> . . . .

In the preceding section of this order it was determined that the Plaintiff had made a prima facie showing that the Swiss Defendants had transacted business in Ohio. This

necessarily means that service of the summons and complaint was authorized by Ohio Rule 4.3.[8] Accordingly, the instant case falls within the scope of Federal Rule 4(e) and service could properly be perfected in the manner described in Federal Rule 4(i)(1)(B).

D. Venue

Defendant Gysler moves pursuant to Fed.R.Civ.P. 12(b)(3) to dismiss the claims against him because the case is improperly venued under 28 U.S.C. § 1391(b) and 18 U.S.C. § 1965(a).[9] In light of the fact that all Defendants do not reside in this judicial district, venue will be appropriate under § 1391(b) only if the claim is found to have arisen within the Northern District of Ohio.

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[8] In addition, the court finds that the Plaintiff has made a prima facie showing that service of the summons and complaint was authorized pursuant to Ohio Rule 4.3(A)(4) & (9). *See* Affidavit of Karl F. Ehrlich, taken July 25, 1990 (affixed to Plaintiff's Memorandum in Opposition to Defendants' Biosys Corporation and Gustavo Gysler Motion to Dismiss as Exhibit B).

[9] Section 1391(b) provides:

> A civil action wherein jurisdiction is not founded solely on diversity of citizenship may be brought only in the judicial district where all defendants reside, or in which the claim arose, except as otherwise provided by law.

Section 1965(a) provides:

> Any civil action or proceeding under this chapter against any person may be instituted in the district court of the United States for any district in which such person resides, is found, has an agent, or transacts his affairs.

In *Leroy v. Great Western United Corp.*, 443 U.S. 173, 183-84, 99 S.Ct. 2710, 2716-17, 61 L.Ed.2d 464 (1979), the Supreme Court noted that "[i]n most instances, the purpose of statutorily specified venue is to protect the *defendant* against the risk that a plaintiff will select an unfair or inconvenient place of trial." (citation omitted). In discussing § 1391(b) the Court stated that although " . . . Congress did not intend to provide for venue at the residence of the plaintiff or to give that party an unfettered choice among a host of different districts[,] . . . in the unusual case in which it is not clear that the claim arose in only one specific district, a plaintiff may choose between those two (or conceivably even more) districts that with approximately equal plausibility – in terms of witnesses, the accessibility of other relevant evidence, and the convenience of the defendant (but *not* of the plaintiff) – may be assigned as the locus of the claim." *Id.* at 185, 99 S.Ct. at 2717.

The Sixth Circuit construed the *Leroy* case as adopting a "weight of the contacts" test for venue determinations. *Onderik v. Morgan*, 897 F.2d 204, 207 (6th Cir.1989). In addition, the court stated that "venue is appropriate in 'any district in which a substantial part of the acts, events or omissions occurred that gave rise to the claim for relief.' " *Id.* (quoting *Sutain v. Shapiro and Lieberman*, 678 F.2d 115, 117 (9th Cir.1982)). Thus, the Sixth Circuit has clearly held that venue may be appropriate in more than one district.

An examination of the underlying facts of this case makes clear that a substantial number of the acts, events or omissions that gave rise to this complaint occurred in the Northern District of Ohio. First, the plaintiff is located

in the Northern District and is incorporated in the state of Ohio. Second, the products underlying the relationship between the parties are produced in Ohio. Third, the communications which are alleged to constitute mail and wire fraud were all directed into the Northern District.[10] Fourth, Biosys' employees and liaisons with GES, Horsfall and Strauss, were located in the Northern District during the period in question. And fifth, the situs of these causes of action is the Northern District.[11]

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[10] In *Murray v. Allen County Claims & Adjustments, Inc.*, 550 F.Supp. 128 (S.D.Ohio 1982), the plaintiff claimed that certain communications from the defendant violated the Fair Debt Collection Practices Act. These communications originated outside the Southern District of Ohio. In holding that venue was appropriate, the court stated:

> Although no facts have as yet been established, defendant concedes that communications were made to plaintiff after he had moved to the Southern District of Ohio. Assuming that such communications did violate the FDCPA, we can conclude that plaintiff suffered an injury in the Southern District. We further conclude, on the basis of this concession, that the activities that transpired in this district were "not insubstantial in relation to the totality of events giving rise to the plaintiff's grievance."

Id. at 131-32.

[11] In *Lachman v. Bank of Louisiana in New Orleans*, 510 F.Supp. 753, 760 (N.D.Ohio 1981), the court stated that "[i]t is well established that the *situs* of a tort-type cause of action is the location the injury is suffered." (citing *Richards v. United States*, 369 U.S. 1, 11 n. 24, 82 S.Ct. 585, 592 n. 24, 7 L.Ed.2d 492 (1962); other citations omitted). Further, the *Lachman* court noted that even if the *situs* was the location where the last act necessary to constitute the cause of action took place, "[t]he 'last element of a tort cause of action is generally the sufferance of damages." *Id.* at 760 n. 2. "Thus, the 'location of the injury' rule and the 'last act' rule have been merged." *Id.*

Due to the court's holding that venue is proper under § 1391(b), it is not necessary to examine the propriety of venue under § 1965(a).

E. Forum Non Conveniens

Finally, the Defendants claim that this action should be dismissed based upon the doctrine of *forum non conveniens*. This doctrine was laid out by the Supreme Court in *Gulf Oil Corp. v. Gilbert*, 330 U.S. 501, 67 S.Ct. 839, 91 L.Ed. 1055 (1947), in which the Court stated:

> The [district] court will weigh relative advantages and obstacles to fair trial. It is often said that the plaintiff may not, by choice of an inconvenient forum, 'vex,' 'harass,' or 'oppress' the defendant by inflicting upon him expense or trouble not necessary to his own right to pursue his remedy. But unless the balance is strongly in favor of the defendant, the plaintiff's choice of forum should rarely be disturbed.

Id. at 508, 67 S.Ct. at 843 (footnote omitted). In addition, the Court noted that the cases to which the doctrine applies are "rather rare." *Id.* at 509, 67 S.Ct. at 843.

The Sixth Circuit recently held that "[a] plaintiff who is a United States citizen should not be deprived of his choice of forum except when the trial would prove oppressive and vexatious to defendant, out of all proportion to the convenience to plaintiff, or when it would be inappropriate because of administrative or legal problems of the court." *Gould, Inc. v. Pechinery Ugine Kuhlmann*, 853 F.2d 445, 454 (6th Cir.1988). *Gould* was a RICO case brought by a United States corporation against several foreign corporations.

The court fails to find the type of vexatious or oppressive inconvenience required to deprive the Plaintiff of its choice of forum. In addition, of the various conflicting interests involved, one of the most weighty is the interest of the United States in a uniform application of RICO. Accordingly, dismissal under the doctrine of *forum non conveniens* is not appropriate in the instant case.

III. HORSFALL'S MOTION TO APPLY THE LAW OF SWITZERLAND TO THE INTERPRETATION OF THE X-O CONTRACT AND TO THE DEFINITION OF TRADE SECRETS

As noted above, the X-O Contract specifically provided that "[t]his Agreement shall be governed by the laws of Switzerland . . . in case of claims from [GES]." On August 29, 1990, Defendant Horsfall filed a motion requesting that the court apply the law of Switzerland to all claims and interpretations of the X-O Contract and to the definition of trade secrets. The allegation that all of plaintiff's claims arise out of the X-O Contract has already been refuted. *See supra* section II(A). This, however, does not dispose of the issue of Swiss law applicability.

Plaintiff's recovery on numerous counts of its complaint is predicated upon proof of the invalidity of the X-O Contract. For example, Count VI alleges that Horsfall breached the Horsfall Agreement. This, however, is only possible if the X-O Contract, which by its terms replaced all previous contracts between GES and Horsfall, is a nullity. The court will, therefore, be required to interpret

the X-O Contract and determine whether it was the product of fraud.[12] To do so, it is necessary to determine the appropriate law under which to proceed.

Initially, the Plaintiff alleges that the choice of law provision is not relevant due to the presence of fraud. The Plaintiff, however, alleges only general fraud, not fraud in the inducement to enter into the choice of law provisions. Since the Ohio courts have not addressed the effect of general allegations of fraud on a forum selection clause, the court adopts the reasoning of the Supreme Court in *Scherk v. Alberto Culver Co.*, 417 U.S. 506, 94 S.Ct. 2449, 41 L.Ed.2d 270 (1974). In *Scherk*, the Court stated:

> In *The Bremen* [*v. Zapata Offshore Co.*, 407 U.S. 1, 92 S.Ct. 1907, 32 L.Ed.2d 513 (1972)] we noted that forum-selection clauses "should be given full effect" when "a freely negotiated private international agreement [is] unaffected by fraud. . . ." 407 U.S., at 13, 12 [92 S.Ct., at 1915, 1914]. This qualification does not mean that any time a dispute arising out of a transaction is based upon an allegation of fraud, as in this case, the clause is unenforceable. Rather, it means that an arbitration or forum-selection clause in a contract is not enforceable if the *inclusion of that clause in the contract* was the product of fraud or coercion.

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[12] The Plaintiff alleges that because Horsfall is not a party to the X-O Contract, he has no standing to assert that Swiss law be used to interpret it. As has been shown, however, recovery on several of Plaintiff's claims against Horsfall is predicated upon a showing that the X-O Contract is void. Horsfall certainly has standing to move the court regarding the interpretation of the contract, either as a third-party beneficiary thereof, or as a litigant with a material interest in the court's determination.

Id. at 519 n. 14, 94 S.Ct. at 2457 n. 14. The Court's reasoning is equally persuasive when applied to choice of law provisions. Thus, absent concrete allegations of fraud regarding this particular provision, the court turns to Ohio law to ascertain the enforceability of this provision.

In *Schulke Radio Prods., Ltd. v. Midwestern Broadcasting Co.*, 6 Ohio St.3d 436, 453 N.E.2d 683, 686 (1983), the Supreme Court of Ohio adopted the reasoning of Section 187 of the Restatement of Laws 2d, Conflict of Laws (1971) 561 which states:

> (2) The law of the state chosen by the parties to govern their contractual rights and duties will be applied, even if the particular issue is one which the parties could not have resolved by an explicit provision in their agreement directed to that issue, unless either
>
> (a) the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice, or
>
> (b) application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which, under the rule of § 188, would be the state of the applicable law in the absence of an effective choice of law by the parties.

It is clear in the instant matter that a substantial relationship exists between Switzerland and both the Defendants and the transaction in question. In addition, Plaintiff fails to allege any fundamental policy of Ohio which is violated by the application of Swiss law. Accordingly, the

choice of law provision will be enforced and Swiss law will be used to interpret and determine the validity of the X-O Contract. There is no other area in which it would be appropriate to apply Swiss law at this time.[13]

For the reasons stated herein, the Swiss Defendants' motion to dismiss is DENIED and Horsfall's motion to apply Swiss law is GRANTED to the extent that Swiss law is necessary to interpret the X-O Contract.

IT IS SO ORDERED.

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[13] Horsfall provides no support for his assertion that Swiss law should be applied to the definition of trade secrets. Accordingly, the court finds no reason to apply the laws of Switzerland in this area.

[Published and Cited as 136 F.R.D. 130
(N.D. Ohio 1991)]

GENERAL ENVIRONMENTAL SCIENCE CORPORATION, Plaintiff,

v.

Frank L. HORSFALL, et al.,
Defendants.

No. 1:90-CV-1340.

United States District Court,
N.D. Ohio, E.D.

April 4, 1991.

Action was brought alleging fraudulent scheme to appropriate trade secrets and proprietary information. On variety of discovery motions, the District Court, Battisti, J., held that defendant owners and employees of nonparty Swiss corporation alleged to be sham created to evade discovery and illegally compete with plaintiff were required to provide to plaintiff documents within their control relating to Swiss corporation and concerning alleged fraudulent scheme to appropriate plaintiff's trade secrets and proprietary information.

Ordered accordingly.

Jerome F. Weiss, William T. Davis, Weiss, Neiditz & Associates, Cleveland, Ohio, for plaintiff.

Thomas C. Buford, Jason Collier Blackford, Weston, Hurd, Fallon, Paisley & Howley, Cleveland, Ohio, for defendants.

ORDER

BATTISTI, District Judge.

Before the court are: (1) Plaintiff General Environmental Science Corp.'s ("GES") Motion to Compel; (2) Defendants Biosys Corporation ("Biosys"), Gustavo Gysler, John L. Strauss and Frank L. Horsfall's Motion for a Protective Order; (3) Defendants Biosys and Gysler's Motion for a Protective Order Against a deposition in the United States; and (4) Defendant Horsfall's Motion to Compel Discovery.

The facts of this case were stated by the court in a previous opinion. *General Environmental Science Corp. v. Horsfall*, 753 F.Supp. 664 (N.D.Ohio 1990). Further details are best left to be raised in the context of the motion to which they are most relevant.

I. PLAINTIFF'S MOTION TO COMPEL

At the heart of the discovery dispute between the two parties is information about the Biosphere Corporation ("Biosphere"), a non-party Swiss corporation. The Defendants have refused to answer interrogatories and deposition questions or to provide documents which relate to Biosphere. The Defendants argue that Biosphere is an active, separate and distinct entity, and therefore, need not respond to discovery requests arising from a civil action in the courts of the United States.

Plaintiff, on the other hand, alleges that the Biosphere is a sham, created for the dual purpose of evading discovery and illegally competing with GES. Plaintiffs further claim that since Gysler, Horsfall and Strauss are

owners and officers of Biosphere, they can be compelled to produce documents which are in their control, provided that the information is discoverable.

Due to the importance of this issue to the orderly development of this action, the court heard arguments from the parties in open court on February 6, 1991. For the reasons stated herein, the Plaintiff's Motion to Compel is Granted, and the Court adopts the Plaintiff's Proposed Confidentiality Order.

The court will focus first on Plaintiff's request for documents. Federal Rule of Civil Procedure 34 provides for the discovery of documents in the "possession, custody or control" of a party to an action, provided that the documents "constitute or contain" matters within the proper scope of discovery as defined in Rule 26(b). The questions before the court, therefore, are whether the documents concerning Biosphere are discoverable, and if so whether they are in the control of the Defendants. On these issues, the evidence presented by the Plaintiff is overwhelming.

It is clear that the Plaintiff is not attempting to conduct a fishing expedition, but instead, seeks to acquire documents that go to the very heart of its allegations that the Defendants have engaged in a fraudulent scheme to appropriate GES trade secrets and proprietary information.

The key to Plaintiff's argument is the Affidavit of Karl F. Ehrlich, taken July 25, 1990 and affixed to Plaintiff's Motion to Compel as Exhibit F (hereinafter the "Ehrlich Affidavit"), which provides independent support for Plaintiff's version of the facts.

Ehrlich is the co-founder of Aquaresearch Ltd. ("Aquaresearch"), a GES Customer, and a Biosys acquisition target.[1] Ehrlich Affidavit at ¶ 1. During August, 1989, Strauss and Horsfall travelled to Aquaresearch's headquarters in Quebec to propose its acquisition by ABT. *Id.* at ¶ 5. Ehrlich claims to have been told that: (1) the three principals of ABT were Gysler, Strauss and Horsfall; (2) Strauss provided marketing expertise, Gysler administered the company and provided expertise in structuring shell corporations, and Horsfall provided technical support in the microbiology area; (3) ABT planned to apply for patents for products and processes similar to those used and marketed by GES; and (4) because of this product overlap Horsfall and Strauss were not publicly acknowledged as principals of ABT.[2] *Id.* at ¶ 6.

Ehrlich further claims to have been told that ABT, at that time operating as the X-O Corporation ("X-O"), was "entering into a contract with GES that they never intended to honor, and that they planned in the future to

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[1] At the time Biosys was known as Applied Bio-Technology ("ABT"). It is not clear whether ABT subsequently changed its name to the X-O Corporation, and then to Biosys, or whether all three are separate corporate entities. Needless to say, it is somewhat difficult to follow the ball amidst the plethora of corporate entities that the Defendants have left in their wake.

[2] As was noted in this court's prior opinion, both Strauss and Horsfall were bound at that time by non-competition clauses in their contracts with GES. *General Environmental Science Corp. v. Horsfall*, 753 F.Supp. 664, 666 (N.D.Ohio 1990).

break . . . as soon as they could set up their own production facilities[,] and that they would use product variability and potency as a basis for breaking the contract and competing. *Id.* at 8. Ehrlich makes a similar claim in a December 29, 1989 letter to Gysler and Strauss in which he states:

> We were told that the patents were submitted in the UK but that you are not identifiable, because your attorneys or secretary or whomever are listed as in charge of ABT. This was necessary as I understand because of your non-compete contract with GES, which you intend to break, based on product nonconsistency, once you have developed your own production facilities.

Id., Exhibit 3. On May 4, 1990 and May 15, 1990, Gysler sent letters to GES attempting to repudiate the contract between GES and X-O on the basis of product variability. Plaintiff's Supplemental Brief in Opposition to Defendants Biosys Corporation and Gustavo Gysler's Motion to Dismiss, Exhibit D.

The events leading up to this litigation lend a great deal of credibility to Ehrlich's statements, including the claim that Gysler was represented as an expert in the formation of shell corporations. Notably, on May 4, 1990, the date of the first letter attempting to repudiate the X-O Contract, Biosphere was formed, with Gysler listed as its Managing Director.

The documents sought are relevant and appear reasonably calculated to lead to the discovery of admissable [sic] evidence.

The court, therefore, looks to the law concerning the scope of the term "control" as used in Rule 34. In the context of Rule 34. "[c]ontrol is defined not only as possession, but as the legal right to obtain the documents requested upon demand." *Searock v. Stripling*, 736 F.2d 650, 653 (11th Cir.1984).

Initially in arguing this motion, the parties focused on the relationship between Biosys and Biosphere. The Plaintiff claimed, and still claims, that Biosys and Biosphere are alter egos that have repeatedly exercised control over the others' documents and proprietary information.

A particularly stark example of this is presented by two letters, dated August 3, 1990, from Gysler to a Biosys/Biosphere client, Eldorado. Reply Memorandum in Support of Plaintiff's Motion to Compel Discovery, Exhibits I & J. The first letter, written on Biosys stationery and signed on behalf of Biosys, informs Eldorado that some contamination has been found in the "old product." The second letter, written on Biosphere stationery and signed on behalf of Biosphere, states that "the recent quality problem found by Biosys . . . in the old Bioclean product has no relation to the new Bioclean II UHC Concentrate product, produced by us in Switzerland, which we have recently shipped to you." Both letters, however, are signed by Gysler, have the same address, phone number and fax number, and significantly, have fax label headings that identify them as communications from Biosphere.

In addition, through the discovery process, the Defendants have provided to the Plaintiff other documents which, according to their fax label headings, were sent by Biosphere. Plaintiff's Motion to Compel Discovery, Exhibits G & H.

As the Plaintiff has pointed out, a number of courts have compelled a corporate party to a lawsuit to obtain documents in the possession of a corporate non-party where there existed a sufficient structural interlocking of the two companies. *See, e.g., Gerling International Insurance Co. v. Commissioner of Internal Revenue,* 839 F.2d 131, 140-41 (3rd Cir.1988) (citing numerous cases in which the requisite control was found to exist between parents and subsidiaries, and sister corporations).[3]

The Defendants vehemently object to the suggestion that Biosys and Biosphere are alter egos, and have presented extensive arguments to the contrary, based upon both the case law and facts drawn from various affidavits.[4] It is not, however, necessary for the court to make a determination on this issue. Even if Biosys does not have control over the requested documents, Gysler, as the

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[3] The *Gerling* case is not directly analogous to this case because in *Gerling* the corporation officer from whom information was sought was not a party to the suit.

[4] The overlapping ownership of Biosys and Biosphere, however, provides evidence of significant structural interrelation between the two companies. At times relevant to Plaintiff's Complaint, Gysler and his father owned 83% of the equity of Biosys, and Strauss and Horsfall, according to the Ehrlich Affidavit, were silent partners in the venture. These three Defendants also own 68.5% of Biosphere.

Managing Director of Biosphere, certainly has legal access to and control over the documents at issue.

An individual party to a lawsuit can be compelled to produce relevant information and documents relating to a non-party corporation of which it is an officer, director or shareholder. In *Weaver v. Gross*, 107 F.R.D. 715, 716 (D.D.C.1985), the court compelled an individual defendant who was the president and chief executive officer of a non-party corporation to answer interrogatories about the corporation and provide corporate documents. The court held that the roles of the corporation and the individual defendant were "inextricably intertwined, especially where there is a basis in fact for concluding that [the president and CEO] did have a pervasive influence in corporate activities." *Id.* at 718. *See also A.F.L. Falck, S.p.A. v. E.A. Karay Co., Inc.*, 131 F.R.D. 46, 48-49 (S.D.N.Y.1990) (compelling individual respondent to produce corporate documents from two nonparty corporations over which he exercises control); *Scott v. Arex, Inc.*, 124 F.R.D. 39, 41 (D.Conn.1989) (compelling owner of corporations to answer interrogatories and produce documents regarding the companies' payrolls); *Haseotes v. Abacab International Computers, Inc.*, 120 F.R.D. 12, 15 (D.Mass.1988) (holding that "individual defendants as officers, directors, and shareholders . . . can be required to produce documents that are in the possession of the corporation.").

The limited evidence available to the court about Biosphere indicates that it is largely controlled by the individual Defendants to this action. They own a majority of its equity, and Gysler is its Managing Director. The

Defendants undoubtedly exercise control over the documents requested, and must provide them to the Plaintiff.

Inasmuch as information about Biosphere is within the scope of Rule 26(b), all Defendants are also ordered to answer Plaintiff's interrogatories and deposition questions concerning Biosphere. Gysler, Strauss and Horsfall, in particular, as owners and employees of Biosphere, have no right to refuse to provide the information requested by the Plaintiff.

In addition, all Defendants are advised to reexamine the analysis of Article 273 of the Swiss Penal Code provided in this court's order of September 14, 1990. Inasmuch as the Defendants own a majority interest in Biosphere, they can hardly expect to hide behind Article 273.

Accordingly, the motion to compel is GRANTED and the Defendants are ordered to provide information responsive to the Plaintiff's discovery requests regarding Biosphere within twenty (20) days of the issuance of this order.

In addition, the Plaintiff's motion for an award of costs and attorney's fees is GRANTED. The Plaintiff will submit a detailed accounting of costs and attorney's fees arising from this motion to compel.

Finally, having evaluated the various confidentiality orders submitted by the parties, the court enters the attached order, drafted by the Plaintiff.

II. DEFENDANTS' MOTION FOR A PROTECTIVE ORDER

The confidentiality order entered by the court provides sufficient protection to the Defendants. Accordingly, the motion for a protective order is DENIED. Plaintiff's request for an award of costs and attorney's fees is DENIED.

III. HORSFALL'S MOTION TO COMPEL

The Plaintiff has indicated that it is willing to respond to Horsfall's interrogatories, provided that the responses are protected by a confidentiality order. Inasmuch as the court has agreed to enter the Plaintiff's proposed confidentiality order, the motion to compel is GRANTED. In addition, the cross motions for an award of costs and attorney's fees are DENIED.

IV. BIOSYS AND GYSLER'S MOTION FOR A PROTECTIVE ORDER

The motion for a protective order is DENIED. The costs of the depositions will be assessed pursuant to Federal Rule of Civil Procedure 54(d) at the end of this action. The Defendants are ordered to present themselves in Cleveland for depositions within twenty (20) days of the entry of this order.

V. CONCLUSION

In summary, the court has made the following rulings: (1) Plaintiff's motion to compel is GRANTED, and

the Plaintiff is awarded the reasonable expenses, including attorney's fees, incurred in obtaining this order; (2) The Defendants' motion for a protective order is DENIED, and the Plaintiff's motion for an award of costs and attorney's fees is DENIED; (3) Horsfall's motion to compel is GRANTED, and the cross motions for an award of costs and attorney's fees are DENIED; (4) Biosys and Gysler's motion for a protective order is DENIED; and (5) the attached confidentiality order is entered.

IT IS SO ORDERED.

APPENDIX

ORDER OF CONFIDENTIALITY

IT IS HEREBY ORDERED as follows that,

1. Any party herein producing copies of documents ("producing party") may designate some or all of such documents as "confidential" by stamping them as "confidential," or by clearly designating documents as confidential in a separate statement, only if the producing party believes, in good faith, that such documents contain or reflect trade secrets, non-public proprietary or commercial information or other confidential matters for which a protective order would be legally justified under Rule 26(c), Fed.R.Civ.P.

2. As used herein. "qualified person" means in addition to this Court, an individual who is:

> (a) Counsel to any of the parties herein, including paralegals, secretary, and other such employees of such counsel who are assisting counsel in this litigation;

(b) An expert consulted by such counsel in connection with the prosecution or defense of this litigation, provided that such expert may examine confidential information solely for the purpose of providing assistance to counsel in connection with the litigation and may not reveal such confidential information to any other person not bound by this Order;

(c) Any defendant in this action, including any person who becomes a defendant subsequent to the execution of this Order;

(d) Any plaintiff in this action, including any person who becomes a plaintiff subsequent to the execution of this Order;

(e) Any person whom a party intends in good faith to call as a witness at the trial of this proceeding and any person whom a party in good faith believes will be called at the trial of this proceeding;

(f) Court reporters while in the performance of their official duties, provided that such persons may retain confidential documents only as long as is necessary for the conduct of their duties in this litigation. Further, plaintiffs and defendants reserve the right to make applications on motion with notice to the Court of the inclusion of any additional category of "witness" as a qualified person.

3. Confidential materials and information provided by or on behalf of any person shall not be made available by any person to persons other than qualified persons, except as provided herein. Prior to the disclosure of any confidential information to any person authorized to inspect such information under Paragraph 2 above, with

the exception of persons referenced in Paragraph 2(a), such person shall execute under oath an "Agreement To Be Bound by Order Regarding Confidentiality" in the form attached hereto.

4. If any party produces documents by making original documents available for inspection and copying, then at the time of inspection all such documents shall be deemed "confidential" within the meaning of this Order. The inspecting party shall then designate the original documents for copying, and the producing party shall designate on the copies those documents which the producing party deems to be "confidential" within the meaning of this Order. Any copies not so designated shall not be deemed "confidential" within the meaning of this Order.

5. Information disclosed or documents referred to at the deposition of any witness, including a party or one of its present or former officers, directors, employers, agents, or independent experts, may be designated by any party as confidential, in accordance with the criteria set forth in Section 1 of this Order, by indicating to the other parties which pages, page or portions of a page of a deposition transcript and which documents contain such confidential information. The party wishing to designate such material as confidential must do so within twenty days after receipt of the transcript. Until such time as that designation is made or the 20 days expire, the whole transcript and all documents referred to therein shall be deemed confidential.

6. All confidential discovery material and the information contained therein or derived therefrom may be

used solely for purposes of this action and may not be used for any other purposes, including, without limitation, any competitive purpose.

7. Confidential materials covered by this Order which are used in connection with any motion, hearing, or other proceeding herein shall be filed under seal and submitted to the Court *in camera*.

8. The Clerk of the Court is directed to maintain under seal all documents, pleadings, or transcripts of deposition testimony filed with the Court in this litigation that a party has designated, in whole or in part, as confidential or as containing confidential information.

9. Upon the resolution of the disputes between the parties, the receiving party shall return to the producing party all documents containing confidential information or, if the parties agree, cause such documents to be destroyed. On request, a letter certifying such return or destruction shall be delivered by the receiving party to the producing party. All qualified persons who have been privy to such protected information shall, even after conclusion of the litigation, be under a continuing duty not to reveal such information for so long as such information is not otherwise available to the public.

10. Any party may seek to modify, expand, cancel, or supersede this agreement by stipulation of the parties or by motion on notice. Nothing herein shall:

> (a) operate as an admission by any party that any particular discovery material contains or reflects trade secrets, non-public proprietary or commercial information or other confidential matters; or

(b) prejudice in any way the rights of any party to object to the production of documents it considers not subject to discovery; or

(c) prejudice in any way the rights of a party to seek a court determination of

(i) whether particular discovery material shall be produced; or

(ii) if produced, whether such material should be subject to the terms of this Order; or

(d) prejudice in any way the rights of a party to apply to the Court for a further order relating to any confidential information.

11. This Order does not purport to govern the handling of confidential discovery material introduced at trial or in other court proceedings related to this lawsuit. Protection of confidential discovery material in such proceedings is left to the further agreement of the parties and order of the Court.

12. In the event additional persons become parties to this litigation, they shall not have access to confidential information produced by or obtained from any other party to this action until the newly-joined party by its counsel and existing parties to this action have executed and filed with the Court this Order.

13. All counsel of record in this action and all members and employees of their respective law firms will take all steps reasonably necessary to comply with this Order.

14. Designation of any document as "confidential" does not mean that for any purposes that that document necessarily contains or reflects trade secrets or nonpublic

proprietary or confidential information or other confidential matters. Such designation as "confidential" cannot be either a presumption, inference or evidence that such document contains or reflects trade secrets or non-public proprietary commercial information or other confidential matters.

IT IS SO ORDERED.

AGREEMENT TO BE BOUND BY
ORDER REGARDING
CONFIDENTIALITY

The undersigned hereby acknowledges that he/she has read the foregoing Order of Confidentiality in *General Environmental Science Corporation v. Frank Horsfall, et al.*, in the U.S. District Court, Northern District of Ohio, Case No. 1:90CV1340, and that he/she understands the terms of the Order and agrees to be bound by it.

_____

Name (Typed)

_____

Signature

STATE OF OHIO

ss.

COUNTY OF CUYAHOGA

BEFORE ME, a Notary Public in and for said County and State, personally appeared the above-named ____, who acknowledged that he/she did sign the foregoing instrument and that the same is his/her fee act and deed.

IN TESTIMONY WHEREOF, I have set my hand and official seal at ___, Ohio, this __ day of ___, 1990.

NOTARY PUBLIC

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

GENERAL ENVIRONMENTAL SCIENCE CORPORATION Plaintiff, -vs- FRANK L. HORSFALL, et al., Defendants.	)	1:90 CV 1340 **ORDER** (Filed May 24, 1991)

Battisti, J.

Before the court are the Plaintiff's motion for sanctions, the Defendant's motion for an extension of time to respond thereto, and the Defendant's motion to modify this court's April 4, 1991 order (the "April 4 Order").

On April 4, 1991, the court granted the Plaintiff's motion to compel discovery and ordered the Defendant's [sic] to provide documents and to present themselves for deposition within twenty days. It has become clear that the Defendant's [sic] violated the April 4, 1991 order. On May 15, 1991, a status conference concerning the appropriateness of sanctions was held with a court reporter present. The Defendants were warned that further intransigence on their part could lead to the imposition of ultimate sanctions.

The court requested the parties to prepare proposed orders to respond to the Defendants' violation of the April 4 Order. Having examined the parties submissions, it is ordered that:

1. By prior order of the court all documents requested and all outstanding responses to the interrogatories should have been submitted to Plaintiff's counsel by Monday May 21, 1991;

2. The deposition of Defendant Frank Horsfall shall commence on Tuesday, May 28, 1991 at 10:00 a.m. at the offices of Jerome F. Weiss and Associates, Office 630, The Leader Building, Cleveland, Ohio;

3. The deposition of Defendant John Strauss shall commence on Tuesday, June 4, 1991 at 10:00 a.m. at the offices of Jerome F. Weiss and Associates, Office 630, The Leader Building, Cleveland, Ohio;

4. The deposition of Defendant Gustavo Gysler, in his personal capacity and in his capacity as representative of Defendant Biosys, S.A. shall commence on Tuesday, June 11, 1991 at 10:00 a.m. at the offices of Jerome F. Weiss and Associates, Office 630, The Leader Building, Cleveland, Ohio;

5. Plaintiff's Supplementary Responses to Defendant Horsfall's Interrogatories, filed under seal with the Clerk on May 6, 1991, shall be unsealed and made available to the Defendants, subject to the Order of Confidentiality (entered by the court as part of the April 4 Order) immediately upon the issuance of this order;

6. To prevent prejudice to the Plaintiff, the Defendant's, as well as their officers, employees and agents, are hereby enjoined and restrained, until further order, from:

    a. competing with Plaintiff in the manufacture, distribution or sale of micro-biological products used for bacterial augmentation in waste water treatment and aquaculture in violation of their prior contractual obligation to Plaintiff;

b. using in any way the trade secrets of Plaintiff, including but not limited to formulas, processes, and techniques related to Plaintiff's products and the identity of Plaintiff's customers;

c. selling, transferring, or otherwise disposing of property which might be used to satisfy a judgment pursuant to Ohio Rev. Code Ann. § 2923.34, including, but not limited to the property listed in Appendix A to this order;

d. transmitting to any third party, including but not limited to Bio Abengoa, Novabia-Spain, Novabia-France, and Cabinet Lebesque Fermentation, any information relative to the composition, manufacture or use of LLMO or systems involving LLMO;

e. selling or putting into the stream of commerce in whatever manner any previously manufactured microbiological product relating to the purification or treatment of waste water or of aquaculture, the present manufacture of which would violated [sic] section 6(b) of this order;

f. denigrating in any manner the LLMO products or techniques or personnel of Plaintiff to any person, including, but not limited to any authority or any customer or user; and

g. engaging in any conduct which is alleged in the Verified Complaint in violation of 18 U.S.C. § 1962 or Ohio Rev. Code § 2923.34;

7. Plaintiff's Motion for Sanctions will be held in abeyance with the exception that the Plaintiff is awarded all costs and attorney's fees expended to date on bringing the motion for sanctions, responding to the motion to modify the April 4 Order, appearing at the May 15, 1991 conference, and preparing the proposed orders Fed R. Civ. P. 37(b)(2). The Plaintiff will submit a detailed accounting of the costs and attorney's fees

arising therefrom. Defendants may object to the Plaintiff's summary of costs and fees within twenty days of the filing thereof. At that time, the Defendants shall also file any objections to the Plaintiff's previously submitted accounting of costs and fees relating to the April 4, 1991 award of sanctions. The Plaintiff may renew his motion for additional sanctions after June 12, 1991, if it is appropriate.

The Defendants will then have ten days to respond.

IT IS SO ORDERED.

/s/ Frank J. Battisti
Frank J. Battisti
United States District Judge

APPENDIX A

a) property owned by Frank L. Horsfall located at 14721 South Woodland Road, Shaker Heights and described as follows:

Situated in the City of Shaker Heights, County of Cuyahoga and State of Ohio: and known as being part of Sublot No. 68 in the Shaker Heights Land Co's Southington Subdivision of part of Original Warrensville Township Lots Nos. 21, 22, 26 and 28 of Cuyahoga County Records, and bounded and described as follows:

Beginning on the Northerly line of South Woodland Road, 60 feet wide, at a point distant 88 feet Easterly, from the Southwesterly corner of said Sublot No. 68; thence North 08° 11' 20" East, 97 feet to a point; thence North 64° 39' 19" East, 68.08 feet to the

Southwesterly line of Woodbury Road, 50 feet wide; thence South 40° 55' 10" East along the said Southwesterly line of Woodbury Road, 165.46 feet to a curved turnout between the said Southwesterly line of Woodbury Road, and the said Northerly line of South Woodland Road; thence Southwesterly along said curved turnout along the arc of a curve deflecting to the right, 36.42 feet, said curve having a radius of 15 feet, the chord of which bears South 28° 38' 05" West, 28.11 feet to the said Northerly line of South Woodland Road; thence North 81° 48' 40" West, along said Northerly line of South Woodland Road, 172 feet to the place of beginning, as appears by said plat.

Permanent Parcel No. 731-21-058

b) property owned by Frank L. Horsfall located at 3340 Kenmore Road, Shaker Heights, Ohio 44122, and described more fully as:

Sublot No. 562 in Block No. 12 in a Re-Subdivision of the Van Sweringen Company's Subdivision No. 17 of part of Original Warrensville Township Lots Nos. 43 and 44, as shown by the recorded plat in Volume 52 of Maps, Page 1 of Cuyahoga County Records, and being 50 feet front on the Westerly side of Kenmore Road and extending back of equal width 150 feet deep, as appears by said plat, be the same more or less, but subject to all legal highways.

c) property owned by John L. Strauss, located at 1054 Harriman Street, Great Falls, Virginia 22066.

[Published and Cited as 141 F.R.D. 443 (N.D. Ohio 1992)]

GENERAL ENVIRONMENTAL SCIENCE CORPORATION,
Plaintiff,

v.

Frank L. HORSFALL, et al., Defendants.

No. 1:90 CV 1340.

United States District Court, N.D. Ohio, E.D.

March 10, 1992.

Plaintiff in trade secrets suit moved for sanctions based on defendants' destruction of discoverable and inculpatory documents which were subject of pending discovery requests. The District Court, Battisti, J., held that: (1) default judgment was appropriate sanction for defendants' destruction of discoverable evidence and pattern of recurring obstruction, and (2) plaintiff was entitled to award of attorney fees and costs against defendants and their counsel.

Motion granted.

Jerome F. Weiss, William T. Davis, Weiss, Neiditz & Assoc., Cleveland, Ohio, for plaintiff.

Stephen D. Walters, Jason T. Blackford, Thomas C. Buford, Mary C. Golrick, Weston, Hurd, Cleveland, Ohio, for defendants.

ORDER

BATTISTI, District Judge.

This matter comes before the Court on Plaintiff General Environmental Science Corporation's Renewed Motion for Sanctions and the various memoranda, documents, deposition transcripts, affidavits and other materials submitted by the parties concerning this motion.

On November 26, 1991, the Court heard the arguments of counsel and testimony from Defendant Frank Horsfall. Plaintiff contends that Defendants have destroyed discoverable and inculpatory documents which were the subject of pending discovery requests and have otherwise obstructed discovery in such a manner that Plaintiff should be granted default judgment, pursuant to Rule 37(b)(2)(C) of the Federal Rules of Civil Procedure, on its complaint and that Defendant Biosys Corporation's counterclaim should be dismissed. Plaintiff also requests an award against Defendants and their counsel of all attorney fees and costs incurred by Plaintiff in this case. Defendants' position is that they have tried in good faith to comply with discovery requests and Orders of this Court and that Plaintiff is merely attempting to avoid a decision on the merits. For the reasons stated below, Plaintiff's Renewed Motion for Sanctions is granted.

In accordance with Federal Rule 52(a), the Court makes the following findings of fact and conclusions of law.

FINDINGS OF FACT

1. General Environmental Science Corporation ("GES" or "Plaintiff") is a company headquartered in Cleveland, Ohio engaged in the world-wide sale of microbiological products used for bacterial augmentation in waste water treatment and aquaculture. GES is also engaged in other technical aspects relating to the treatment of water.

2. On July 27, 1990, GES filed a complaint alleging theft of trade secrets, fraud, RICO violations and other claims against Frank Horsfall ("Horsfall"), John Strauss ("Strauss"), Gustavo Gysler ("Gysler") and Biosys Corporation ("Biosys") (referred to collectively as "Defendants"). GES alleges that in 1989, Horsfall and Strauss, in the course of developing customers for GES product and technology in Europe, conspired with Gysler to steal the trade secrets of GES by forming a Swiss corporation to act as a distributor of GES product in Europe and then terminated the distributorship agreement with GES on the pretext of product variability and commenced to produce and sell a product derived from GES trade secrets. GES further alleges that Defendants terminated the contract between Biosys and GES by letter dated May 4, 1990. This scheme is outlined in the Affidavit of Karl Ehrlich ("Ehrlich") which is attached to the complaint. Ehrlich allegedly refused to join this conspiracy after Horsfall and Strauss reviewed it with him.

3. On July 30, 1990, this Court entered an Order setting a discovery deadline of September 30, 1990 and a hearing on Plaintiff's Motion for Preliminary Injunction for October 29, 1990.

4. On August 13, 1990 and August 14, 1990, respectively, GES noticed the depositions of Horsfall and Strauss. Horsfall filed a motion for protective order seeking to avoid a deposition on the ground that Swiss law protected him from being deposed. On September 14, 1990, the Court denied Horsfall's motion, characterizing his argument that he was protected by Swiss law as "nothing more than slight of hand."

5. Despite the September Order, Horsfall and Strauss refused to answer deposition questions,[1] refused to answer interrogatories,[2] and failed to produce documents on the ground that to do so would violate Swiss law.

6. On September 19, 1990, GES noticed the depositions of Gysler and Biosys. On September 25, 1990, Gysler and Biosys filed a motion for protective order seeking to be deposed in Switzerland under Swiss procedures.

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[1] For a list of the deposition questions Strauss and Horsfall refused to answer, see Reply Memorandum in Support of Plaintiff's Motion to Compel at 7-8 nn. 4 and 5.

[2] Horsfall and Strauss responded to interrogatories concerning Biosys and Biosphere with the following objection:

> Objection to all disclosures relating to *Biosys* Corporation S.A. of *Biosphere* Corporation which may be a violation of the criminal law of Switzerland. I invoke a constitutional privilege not to disclose any trade secrets, information or documents which would subject me to criminal action in Switzerland.

7. On September 20, 1990, GES filed Plaintiff's Motion to Compel Discovery[3] requesting that the Court order Defendants to produce documents and provide answers to interrogatories and deposition questions. Plaintiff also requested an award of attorney fees and costs pursuant to Federal Rule 37. Defendants opposed the motion on the ground that Plaintiff had failed to comply with Swiss discovery procedures.

8. The evidence submitted in connection with Plaintiff's motion to compel revealed that on May 4, 1990, the same day that Defendants terminated their contract with GES via a letter reviewed and approved by defense counsel Jason Blackford, Defendants formed a new Swiss corporation called Biosphere Corporation ("Biosphere"). Defendants subsequently sought to avoid discovery about their current, allegedly competitive, activities with Plaintiff on the ground that all such information and documents were the property of Biosphere and that the individual Defendants, the principal officers and shareholders of Biosphere, were precluded by Swiss law from disclosing such information and documents.

9. In support of its motion to compel, Plaintiff presented the affidavit of Ehrlich who swore that Defendants attempted to induce him to enter into their scheme to defraud GES and told him that they would execute such scheme through the formation of shell corporations in which Gysler, trained as a lawyer, was an expert. Gysler subsequently confirmed, at deposition, his proficiency in

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[3] GES supplemented its motion with additional filings on October 5, 1990, November 27, 1990 and December 7, 1990.

forming shell corporations. (Gysler Depo. at 38-41, 757-60).

10. On October 8, 1990, the Court continued the hearing on Plaintiff's motion for preliminary injunction because of Defendants' obstruction of discovery through their refusal to answer interrogatories, answer deposition questions or produce documents. On November 28, 1990, the Court continued the hearing on GES's motion for preliminary injunction indefinitely in light of pending motions to compel discovery.

11. On February 6, 1991, the Court held a hearing on Plaintiff's motion to compel discovery and other discovery motions.

12. On April 4, 1991, the Court granted Plaintiff's motion to compel discovery and awarded Plaintiff attorney fees and costs. The Court found that GES was "not attempting to conduct a fishing expedition" and that Plaintiff's discovery requests "go to the very heart of its allegations that the Defendants have engaged in a fraudulent scheme to appropriate GES trade secrets and proprietary information." The Court also found that "Guysler, Strauss and Horsfall, in particular, as owners and employees of Biosphere, have no right to refuse to provide the information requested by the Plaintiff" and that "they can hardly expect to hide behind Article 273." 136 F.R.D. 130. The Court further ordered Defendants to provide all discovery within 20 days, including appearing for deposition in Cleveland, Ohio, within that time.

13. Despite the April Order, Defendants' counsel refused to provide dates for the depositions and informed Plaintiff's counsel that Defendants would not appear for

deposition as noticed. Defendants also failed to produce any documents or interrogatory answers as ordered. Although defense counsel represented to the Court at the time that the delay was caused by the difficulty of communicating with their clients due to the distance between Switzerland and Cleveland,[4] Gysler testified that the real reason for the delay was that "we did not feel that we were obliged to obey the order, according to Swiss law." (Gysler Depo. at 560). Defense counsel also cited Plaintiff's alleged failure to comply with Swiss discovery rules as a reason for Defendants' failure to comply with the April Order.[5] Defense counsel also stated that one of the Defendants had not yet been advised of the April Order.[6]

14. Defendants failed to comply in any respect with the April Order.

15. On April 25, 1991, counsel for both parties met in an attempt to resolve this matter. No documents were produced and defense counsel was unable to provide firm dates for depositions or production of documents.

16. On April 26, 1991, GES filed Plaintiff's Motion for Sanctions seeking default judgment based on Defendants' failure to provide any of the discovery required by the April Order.

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[4] This excuse is refuted by evidence of daily communications between Horsfall who was in Cleveland and the remaining Defendants who were in Switzerland.

[5] *See* Exhibit I attached to Plaintiffs' Motion for Sanctions.

[6] At the hearing, defense counsel stated that defendant in question was not notified because he was traveling. (Transcript of Hearing held November 26, 1991 ("Hearing Trans.") at 50).

17. On May 15, 1991, the Court held a conference with counsel and ordered that Defendants comply with all discovery requests by May 21, 1991 and that Defendants' depositions be taken beginning May 28, 1991. The Court warned defense counsel that further intransigence on Defendants' part could lead to the imposition of ultimate sanctions.

18. On May 24, 1991, the Court entered an order finding that Defendant had violated the April Order. To prevent prejudice to Plaintiff, the Court enjoined Defendants from competing with GES and from disposing of particular property. The Court reiterated its warning to Defendants and awarded Plaintiff the attorney fees incurred in bringing the motion for sanctions and in responding to various motions filed by Defendants.

19. On May 24, 1991, Defendants filed Document A7077 under seal and asked "that the Court protect the confidentiality of the enclosed document, which contains secret formulations of Biosphere products. The Court is requested *not* to release or disclose the sealed document to Plaintiff or Plaintiff's counsel." In the notice of filing, Defendants stated that they were "prepared to satisfy this Court in camera, short of disclosure to Plaintiff or Plaintiff's counsel, that the formulations on Document A7077 differ in type and kind from the formulations of Plaintiff's products to which any Defendant herein had access at any time in the past."

20. There was no authority for filing Document A7077 under seal as the document was covered by the Order of Confidentiality contained in the April Order.

21. In defending the filing of Document A7077 under seal, defense counsel represented that the Court had implicitly agreed to decide the trade secret issues in this case ex parte by failing to mention Document A7077 in the May Order. Defense counsel stated that he was "sure the reason that Judge Battisti did not make reference to Document A7077 in [the May Order] was his recognition that this was the only fair and logical way to proceed." (*See* Exhibit D to Plaintiff's Renewed Motion for Sanctions).

22. The May Order was filed less than fifteen minutes after Document A7077 was filed under seal. Document A7077 was not brought to the Court's attention until well after it issued the May order.

23. Defense counsel subsequently tried to justify his earlier explanation by stating:

> *how could defense counsel know or appreciate that his office had filed document A7077 only minutes before this Court filed its May 24th Order?* Given the flurry of activity as to more than 7000 documents and the arrangements to meet, for the first time, Defendant HORSFALL flying in from Switzerland for Deposition, *how could counsel, under this extreme pressure, know and understand the time frame?*

(See Objections of Defendants to Misstatements in Plaintiff's Proposed Findings of Fact at 6 emphasis in original)). At the hearing, defense counsel admitted that it was "highly unlikely that this Court contemplated document A7077 in [the May Order]." (Hearing Trans. at 31).

24. Despite the April and May Orders, Gysler instructed defense counsel not to disclose Document

A7077 to Plaintiff under any circumstances, (Gysler Depo. at 567, 569). Gysler testified that "[w]hen we decided to supply the files of our company, in violation of Swiss law, we thought it was absolutely not necessary that these formulations be known to GES. . . . " (*Id.* at 568).

25. Defense counsel refused to disclose Document A7077 despite repeated requests by GES counsel and a request by Horsfall. (Horsfall Depo. at 917). Counsel stated that they withheld Document A7077 "under the direct instruction of Biosphere" and "with the full concurrence of all the Defendants." (Hearing Trans. at 32).

26. Document A7077 was an essential document since it would purportedly disclose similarities or dissimilarities between GES's and Defendants' products. Defendants claimed that the document contained "formulations of various products and constitutes a trade secret of the most sensitive nature of Biosphere Corporation, S.A."

27. Horsfall, Strauss and Gysler all testified that Document A7077 contained the formulations for the product line of Biosphere. (Horsfall Depo. at 874-75, 1268 and 1414; Strauss Depo. at 1009; Gysler Depo. at 80; and Hearing Trans. at 53).

28. Horsfall testified that Document A7077 was "a working document" which he and Strauss created. (Horsfall Depo. at 873; Strauss Depo. at 820, 1009-10). Defendants admit that predecessor documents to Document A7077 existed. The first such document was created in October 1990. (Horsfall Depo. at 874). Six successor documents were created and additions, deletions and modifications were made to the "working document"

from time to time. (Horsfall Depo. at 952-53, 1185, 1411). These documents would purportedly trace the development of Defendants' products from the date they terminated their contract with GES. (Horsfall Depo. at 952-53). Horsfall admits destroying the predecessor documents to Document A7077. *Id.* According to Horsfall, the destruction continued from October 1990 to April or May 1991. *Id.*

29. Document A7077 and its predecessor documents were within the scope of Plaintiff's discovery requests and within the scope of documents Defendants were ordered to produce by the April and May Orders. Defendants were aware of the pending discovery requests and the Court orders. (Hearing Trans. at 71).

30. The nonproduction of Document A7077 and the destruction of its predecessors impeded the completion of depositions as ordered by the Court. Plaintiff also contends that the withholding precluded GES from doing technical research and preparation necessary to address the contents of the document and further delayed the retention and preparation of experts.

31. Horsfall denied taking any notes on the course of developing products Defendants used to compete with GES. (Horsfall Depo. at 877). However, Gysler testified that Horsfall kept "a kind of a book[7] where he puts down the daily – when there is a growth, there is the daily analysis, like pH, mainly pH, which is an important

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[7] Gysler later clarified that Horsfall wrote his notes on a pad of paper as opposed to a laboratory notebook. (Gysler Depo. at 578).

factor during growth." (Gysler Depo. at 571). Gysler testified that Horsfall took such notes as early as September or October 1990, two months after Plaintiff's document requests were served. (*Id.* at 573).

32. Gysler testified that Horsfall's working notes relating to the production of Defendant's product were destroyed. Horsfall confirms that no other documents exist regarding development of Defendants' products such as lab books, records of experiments, or testing data. (Horsfall Depo. at 877, 879, 880, 890, 931; Hearing Trans. at 61). According to Horsfall, few documents existed in regard to product development because the formula for the new products simply sprang from his head. (Hearing Trans. at 61).

33. Horsfall's notes were within the scope of Plaintiff's discovery requests and within the scope of documents Defendants were ordered to produce by the April and May Orders. Defendants were aware of the pending discovery requests and the Court orders. (Hearing Trans. at 71).

34. Defendants have destroyed documents that were within the scope of Plaintiff's discovery requests and were ordered to be produced by the April and May Orders.

35. The destruction of documents responsive to Plaintiff's discovery requests has prejudiced Plaintiff.

36. Defendants, through Biosphere, have violated the May Order by engaging in bacterial treatment of waste water. (See also Horsfall Depo. at 901; Strauss Depo. at 889). On June 18, 1991, Bio Abengoa, a customer

allegedly stolen from GES by Defendants[8] wrote to Gysler, after having been advised of the May Order, that "[a]ccording to this Order, it seems that we should stop immediately our activities." (See Exhibit I attached to Plaintiff's Renewed Motion for Sanctions). In response, Gysler noted that "Biosphere Corporation S.A. is not even a party to" this case and that "our counsel in the United States tells us that Biosphere Corporation S.A. is in complete compliance." (See Exhibit J attached to Plaintiff's Renewed Motion for Sanctions).

37. Defendants rely on an unsworn letter from J. Miro Chavarria, President of Bio Abengoa, to refute the allegations that they violated the injunction. The letter purportedly confirms "that our company Bio Abengoa, S.A., is not purchasing and has never purchased any product or other material from either Biosys Corporation or Biosphere Corporation of Rolle, Switzerland." (See Exhibit A attached to Supplemental Memorandum and Evidence of Defendants' Discovery Compliance).

38. On October 10, 1991, the Court awarded Plaintiff attorney fees in the amount of $44,424.75.[9] Defendants subsequently requested clarification as to whether the award was against Defendants or against Defendants and their counsel. Before the Court could address their motion, Defendants appealed. Their appeal is currently pending.

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[8] Gysler and Strauss admitted that Bio Abengoa was a customer of GES. (Gysler depo. at 28-29, 402; Strauss depo. at 808-10).

[9] This order merely fixed the amount of fees which had been previously awarded by the April and May Orders.

39. On November 5, 1991, the Court scheduled the hearing on Plaintiff's Renewed Motion for Sanctions for November 7, 1991.

40. On November 6, 1991, defense counsel provided Document A7077 to Plaintiff's counsel stating that "specific authorization for release of same having now been received from Biosphere."

41. The hearing was continued until November 26, 1991.

42. On November 26, 1991, the Court held a hearing on GES's Renewed Motion for Sanctions and Defendants' Motion to Compel Discovery.[10] The Court heard the arguments of counsel and the testimony of Horsfall. Horsfall's testimony concerning Document A7077 and the predecessor documents appeared to be void of credibility.

43. At the conclusion of the hearing, the Court asked Plaintiff's counsel to prepare proposed filings of fact and conclusions of law. The Court also granted defense counsel's request for leave to present, contemporaneously with Plaintiff, his own proposed findings and conclusions. 40. On December 2, 1991, defense counsel received from Defendants eight pages of documents purporting to be some of the documents which Defendants swore they had destroyed. Defense counsel did not apprise Plaintiff's counsel of his receipt of the documents, although he knew Plaintiff's counsel was preparing proposed findings of facts and conclusions of law.

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[10] Defendants' Motion to Compel was denied on December 18, 1991.

44. On December 6, 1991, defense counsel sent to Plaintiff's counsel, by fax, a letter advising that he was filing some documents under seal and requesting an extension of time to file Defendants' findings of fact and conclusions of law. Without revealing the nature of the documents he intended to file, he suggested that Plaintiff's counsel might "wish to defer filing [its] proposed findings and conclusions until Monday."

45. Counsel for Plaintiff filed the proposed findings of fact and conclusions of law on December 6, 1991. Later that evening, defense counsel delivered to Plaintiff's counsel a Notice of Filing Under Seal by Defendants and Request for One-Day Extension of Time, and Additional Filing by Defendants. With the Notice of Filing Defendants submitted eight pages of documents which they claim were predecessor to Document A7077. Defendants asked that they as well as Plaintiff be permitted a one-day extension to file their proposed findings and conclusions. Plaintiff did not request or consent to be included in this request for extension. Also included with the Notice of Filing was the affidavit of defense counsel stating that he received the documents from Gysler on December 2, 1991. He did not explain why he did not advise Plaintiff's counsel of the availability of these documents on December 2, 1991. Defendants also submitted an unsworn letter from Horsfall stating that he had located two of the documents in a plastic folder in Biosphere laboratory and retrieved the other two documents from their computer using an "undelete" program.

46. In his Affidavit, Horsfall states that he "did not realize until [his] trip to Cleveland, Ohio on November 26, 1991 that Attorney Jerome Weiss was pressing an

issue about alleged destruction of documents." He also stated that immediately upon returning to Switzerland, he searched Biosphere's premises. He failed to indicate why such a search was not conducted when the documents were originally requested or when they were ordered to be produced.

47. Both parties have filed affidavits of purported computer experts concerning the likelihood that Defendants were able to retrieve two predecessor documents to Document A7077 using an "undelete" program.

48. Any Conclusion of Law deemed a Finding of Fact is incorporated herein.

CONCLUSIONS OF LAW

1. Any Finding of Fact deemed a Conclusion of Law is incorporated herein.

2. A district court has the inherent authority to sanction parties for discovery abuses. *Roadway Express, Inc. v. Piper,* 447 U.S. 752, 765, 100 S.Ct. 2455, 2463, 65 L.Ed.2d 488 (1980). If the abuses are egregious, default judgment is appropriate. *National Hockey League v. Metropolitan Hockey Club, Inc.,* 427 U.S. 639, 96 S.Ct. 2778, 49 L.Ed.2d 747 (1976); *Bank One of Cleveland, N.A. v. Abbe,* 916 F.2d 1067 (6th Cir.1990). The purpose of sanctions is "not merely to penalize those whose conduct may be deemed to warrant such a sanction, but to deter those who might be tempted to such conduct in the absence of such a deterrent." *National Hockey League,* 427 U.S. at 643, 96 S.Ct. at 2781.

3. Federal Rule 37 provides in part that:

> [i]f a party . . . fails to obey an order to provide or permit discovery, including an order made under subdivision (a) of this rule . . . , or if a party fails to obey an order entered under Rule 26(f), the court in which the action is pending may make such orders in regard to the failure as are just, [including]
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> * * *
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> *[a]n order . . . dismissing the action or proceeding or any part thereof, or rendering a judgment by default against the disobedient party;*

Federal Rule 37(b)(2)(C) (emphasis added).

4. The Sixth Circuit has set forth the following factors to be considered in determining whether default is an appropriate sanction for noncompliance with discovery orders: (1) whether the failure was due to the party's inability to comply with the discovery request or his willful bad faith or fault; (2) whether the plaintiff was prejudiced by defendant's noncompliance; (3) whether defendants were aware that their failure to cooperate could lead to dismissal; and (4) whether lesser sanctions would serve the goals of punishment and deterrence. *Abbe,* 916 F.2d at 1079.

5. The sanction of default judgment is particularly appropriate where a party destroys discoverable evidence, thereby making that evidence irretrievably unavailable to the opposing party and the trier of fact. *Wm. T. Thompson Co. v. General Nutrition Corp., Inc.,* 593 F.Supp. 1443 (C.D.Cal.1984).

> Sanctions may be imposed against a litigant who is on notice that documents and information in its possession are relevant to litigation, or potential litigation, or are reasonably calculated to lead to the discovery of admissible evidence, and destroys such documents and information. While a litigant is under no duty to keep or retain every document in its possession once a complaint is filed, it is under a duty to preserve what it knows, or reasonably should know, is relevant in the action, is reasonably calculated to lead to the discovery of admissible evidence, is reasonably likely to be requested during discovery, and/or is the subject of a pending discovery request.

Id. at 1455.

6. Defendants' conduct in this case presents a pattern of recurring obstruction of the discovery procedures set forth in the Federal Rules. Defendants have obstructed discovery in this case by blatantly refusing to provide Court ordered discovery, by filing motions for the purpose of delay, by attempting to relitigate points of law decided against them, by ignoring Court Orders with impunity and by destroying discoverable documents.

7. Defendants have used the procedures of the Federal Rules to secure delay after delay while destroying discoverable evidence.

8. Defendants have repeatedly attempted to relitigate points of law decided against them. Defendants have continued to invoke Swiss law as a shield against discovery even though this position was rejected by the Court less than two months after the case was filed. Defendants

have also attempted to relitigate the issue of confidentiality despite the Order of Confidentiality contained in the April Order. Finally, Defendants repeatedly have objected to discovery on the grounds that Biosphere is not a party to this litigation despite the April Order finding that "Gysler, Strauss and Horsfall, in particular, as owners and employees of Biosphere, have no right to refuse to provide the information requested by Plaintiff."

9. Defendants have ignored and violated Court Orders with impunity. Defendants have refused to produce Court ordered discovery. Furthermore, Defendants have engaged in the bacterial treatment of waste water in violation of the May Order.

10. Defendants destroyed notes and the predecessor documents to Document A7077. Defendants do not contend that they were unaware of the document requests made by Plaintiff, or that the documents in issue were not within the scope of such document requests at the time the documents were destroyed. The documents were supposed to be produced in September and October 1990. At that time, Defendants withheld documents based on their purported belief that Swiss law protected them from producing the documents. However, pending this Court's ruling on the motion to compel discovery, Defendants were obligated to preserve responsive documents. Instead, Defendants destroyed the documents.

11. Defendants' conduct in this case confirms that the destruction of those documents was the result of either a bad faith scheme to destroy such documents or an intentional indifference to their discovery obligations.

12. Plaintiff is both presumptively and in fact prejudiced by Defendants' destruction of documents. The destruction of documents creates a presumption that the missing documents would have permitted a plaintiff to prove the illegal conduct which is at the heart of its complaint. *Wm. T. Thompson Co.*, 593 F.Supp. at 1455. "Destroying the best evidence relating to the core issue in the case inflicts the ultimate prejudice upon the opposing party." *Computer Assocs. Int'l, Inc. v. American Fundware, Inc.*, 133 F.R.D. 166, 170 (D.Colo.1990). Prejudice derives from both the irretrievable loss of evidence and the inconvenience and expense suffered in uncovering and investigating the document destruction scheme. *Telectron, Inc. v. Overhead Door Corp.*, 116 F.R.D. 107, 132 (S.D.Fla.1987).

13. The destroyed documents apparently were the only primary scientific data tracing the development of Defendants' product line which they use to compete with GES. Gysler's testimony that lab notes and other date existed is credible since it is highly unlikely that Defendants could have launched a whole product line overnight without some data demonstrating the development of such products. Defendants testified that they have no other lab books, test data, or other notes relating to product development, other than those which Gysler testified existed and were destroyed.

14. Plaintiff was entitled to the requested documents, especially Defendants' notes and date relating to their first efforts at product development which were likely to be more probative because of their closeness in time to Defendants' termination of the relationship with GES. *See Computer Assocs.*, 133 F.R.D. at 170 (default

granted where Defendant had destroyed predecessor versions of computer program). The destroyed documents purportedly reflect the evolution of Defendants' product line which they have allegedly used to compete with GES since May 1990.

15. Plaintiff should not be required to rely on the highly questionable predecessors to Document A7077 which Defendants have produced after swearing that they no longer existed nor should Defendants profit from the destruction of their laboratory notes and other data.

16. Plaintiff has also been prejudiced by Defendants' continuing obstruction of discovery in this case. Because of Defendants' conduct, the hearing on Plaintiff's motion for preliminary injunction was continued indefinitely. Plaintiff was forced to respond to Defendants' attempts to relitigate points of law decided against them. Plaintiff was also forced to file motions to compel to obtain discoverable information.

17. At all times Defendants were able to produce the information and documents requested of them. However, Defendants resisted each and every discovery request made by Plaintiff and did so on grounds which Defendants and their counsel knew had already been rejected by this Court.

18. Defendants were aware that their records were the subject of discovery requests and motions pending before this Court at the time they were allegedly destroyed.

19. Defendants were repeatedly warned by the Court that their refusal to provide discovery could lead to application of ultimate sanctions by the Court.

20. No lesser sanction than default judgment will suffice. Imposition of a lesser sanction would only reward Defendants for their misconduct. *Wm. T. Thompson Co.*, 593 F.Supp. at 1455. "[A]ny lesser sanction would allow a party possessing evidence that would insure an adverse result to destroy that evidence with impunity, thus assuring defeat for the opponent while risking only a comparatively mild rebuke." *Computer Assocs.*, 133 F.R.D. at 170. Defendants' theft of trade secrets is relevant to every claim set forth in Plaintiff's Complaint, and is certainly relevant to the counterclaims set forth by Biosys. A financial penalty in the form of an award of attorney fees is clearly insufficient, since substantial attorney fees have already been awarded in this case with no deterrent effect, and a further award may turn out to be no sanction at all given that Defendants have attempted to place themselves in Switzerland beyond the process of this Court. Further, holding the specific issue of trade secrets to be precluded would, in effect, grant Plaintiff the default judgment sought. Finally, no lesser sanctions will retrieve documents which have already been destroyed, and Defendants will forever have the benefit of such destruction.

21. An order that Defendants resubmit to deposition and produce other documents which have been withheld is likewise futile. Such orders have been issued before and have been openly defied. Defendants have either refused to answer deposition questions or have withheld documents necessary for such depositions,

thereby thwarting at least three attempts to complete the depositions. Further, it is unreasonable to require Plaintiff, his "counsel or this Court to engage in a constant battle against this recalcitrant and obstructionist behavior." *Coleman v. Smith*, 814 F.2d 1142, 1146 (7th Cir.1987). The Court cannot referee every document request as it has this one.

22. Even if such orders were a feasible alternative, they would not compensate for the damage to the judicial process and the integrity of the result in this case occasioned by Defendants' destruction of documents. An important aspect of the application of Federal Rule 37 is not only its effect on the parties before the Court but its effect on other litigants. In *National Hockey League*, the district court dismissed the case after the plaintiffs' failure to answer written interrogatories. 427 U.S. 639, 96 S.Ct. 2778. The Court of Appeals reversed. The Supreme Court of the United States reversed, reinstating the district court's dismissal of the case.

> [T]he most severe in the spectrum of sanctions provided by statute or rule must be available to the District Court in appropriate cases, not merely to penalize those whose conduct may be deemed to warrant such a sanction, but to deter those who might be tempted to such conduct in the absence of such a deterrent. If the decision of the Court of Appeals remained undisturbed in this case, it might well be that *these* respondents would faithfully comply with all future discovery orders entered by the District Court in this case. But other parties to other lawsuits would feel freer than we think Rule 37

> contemplates they should feel free to flout other discovery orders of other District Courts.

Id. at 643, 96 S.Ct. at 2781.

23. Defendants' conduct is much more egregious than that at issue in *National Hockey League*. Any sanction less than default would permit Defendants to profit from the destruction and delay they have caused. No lesser sanctions are appropriate.

24. The mere fact that a party after months of delay and obstruction may feel chastened to comply upon imposition of the ultimate sanction is no basis for withholding that sanction. To permit a party to avoid ultimate sanctions based on a last minute tender of discovery would " 'introduce into litigation a sporting chance theory encouraging parties to withhold vital information from the other side with the hope that the withholding may not be discovered and, if so, that it would only result in a fine.' " *G-K Properties v. Redevelopment Agency of City of San Jose*, 577 F.2d 645 (9th Cir.1978). In *G-K Properties*, the appellate court upheld a district court's dismissal of a complaint with prejudice for failure to comply with discovery orders despite plaintiff's tender of discovery after the filing of a motion to dismiss. The Court of Appeals held:

> Here the court dismissed the Plaintiff's action with prejudice. It acted properly in so doing. We encourage such orders. Litigants who are willful in halting the discovery process act in opposition to the authority of the court and cause impermissible prejudice to their opponents. It is even more important to note, in this era of crowded dockets, that they also deprive other

> litigants of an opportunity to use the courts as a serious dispute-settlement mechanism. Here the appellants' last-minute tender of relevant documents could not cure the problem they had previously created.

Id. at 647. Therefore, Defendants' last minute tender of Document A7077 and its alleged predecessors is no basis for declining to impose ultimate sanctions.

25. Furthermore, the circumstances in which documents were filed raise serious questions about their last-minute "discovery." Defendants and their counsel have maintained since May that these documents had been destroyed. Only when this Court had taken Plaintiff's Renewed Motion for Sanctions under advisement were these documents suddenly "discovered." The documents were discovered only days after Horsfall swore before this Court that the documents had been destroyed. These circumstances raise serious questions about the completeness of Defendants' production of other documents in this case. Although the alleged predecessors of Document A7077 have been "discovered," the laboratory notes and other data which Gysler testified existed have not been produced.

26. The evidence permits the inference that Defendants only produced the documents to avoid judgment being entered against them as a discovery sanction. Documents originally requested in August 1990 were produced in December 1991 after multiple discovery motions, two court orders compelling discovery, four hearings and many warnings by the Court that ultimate sanctions would be imposed. Only when Defendants

thought a judgment against them was imminent did they "produce" these documents.

27. The Court, having issued multiple orders compelling discovery, having warned defense counsel personally that ultimate sanctions would be considered if further resistance were encountered, and having awarded substantial attorney fees, is at a loss as to how to remedy this matter short of default judgment. The granting of a default judgment is the only way to stop the endless parade of discovery disputes Defendants have manufactured and required this Court to decide. This has been to the prejudice of GES and to other litigants who vie for the limited judicial resources available. Defendants' shams are at an end. In totality, Defendants' continuing obstruction of discovery in this case requires that this Court grant default judgment in favor of GES on its Complaint and dismiss with prejudice the counterclaim of Biosys.

28. Therefore, Defendants, their officers, agents, employees as well as any entities subject to their control, are hereby permanently enjoined and restrained from:

a) competing with Plaintiff in the manufacture, distribution or sale of micro-biological technology, products and/or systems used for bacterial augmentation in waste water treatment and aquaculture;

b) using in any way the trade secrets of Plaintiff including but not limited to, formulas, processes or techniques related to Plaintiff's products and systems and the identity of Plaintiff's customers;

c) selling, transferring or otherwise disposing (without prior approval of the Court) of

property which might be used to satisfy a judgment pursuant to R.C. § 2923.34;

d) transmitting to any third party, including but not limited to Novabio-Spain, Novabio-France, Cabinet Lebesque Fermentation, and Bio Abengoa, any information relative to the composition, manufacture or use of LLMO or similar products or data or systems involving LLMO or similar products;

e) selling or putting into the stream of commerce in whatever manner any micro-biological product relating to the purification or treatment of waste water and of aquaculture;

f) denigrating in any manner the LLMO products, or techniques, or personnel to any person, including but not limited to any authority or any customer or user; and

g) engaging in any of the activity alleged in the Complaint.

29. Federal Rule 37 provides that, in addition to the other sanctions imposed or orders issued, "the court shall require the party failing to obey the order or the attorney advising the party or both to pay the reasonable expenses, including attorney's fees, caused by the failure" to provide discovery.

30. Furthermore, federal district courts retain inherent power to award attorney fees to punish bad faith abuse of process and emasculation of the Federal Rules. *Chambers v. NASCO, Inc.*, ___ U.S. ___, 111 S.Ct. 2123, 115 L.Ed.2d 27 (1991). This power extends to assessing fees against a party as well as his attorneys. *In re Ruben*, 825

F.2d 977, 983 (6th Cir.1987), *cert. denied*, 485 U.S. 934, 108 S.Ct. 1108, 99 L.Ed.2d 269 (1988) (citation omitted).

31. In *Chambers*, the Supreme Court upheld an award against the defendant of the plaintiff's entire attorney fees in the case under the district court's inherent power. In *Chambers*, the defendants and counsel, although repeatedly warned by the district court, engaged in delaying and obstructive behavior, such as continuing to contest issues decided by this Court, and contesting issues until the last minute and then withdrawing their opposition, solely for the purpose of delay and harassment.

32. The district court retains discretion as to how it should exercise its inherent power. "A primary aspect of that discretion is the ability to fashion an appropriate sanction for conduct which abuses the judicial process." 111 S.Ct. at 2132-33. This discretion encompasses both dismissal of the entire case, or, of course, an award of attorney fees, and extends to an assessment of attorney fees against counsel as well as "attorney's fees representing the entire cost of the litigation." *Id.* at 2133. Attorney's fees may be awarded

> when a party "shows bad faith by delaying or disrupting the litigation or by hampering enforcement of a court order. . . . " The imposition of sanctions in this instance transcends a court's equitable power concerning relations between the parties and reaches a court's inherent power to police itself, thus serving the dual purpose of "vindicat[ing] judicial authority without resort to the more drastic sanctions available for contempt of court and mak[ing] the

> prevailing party whole for expenses caused by his opponent's obstinacy."

Id.

33. The Court has already found that Defendants acted in bad faith. Therefore, Plaintiff is entitled to an award of all of their attorney fees and costs incurred in this litigation.

34. Counsel for Defendants are just as culpable. They too have displayed a willingness to frustrate and obstruct court orders.

35. Counsel continued to rely on Swiss discovery procedures to object to deposition questions, interrogatories and document requests, despite the September Order rejecting the applicability of Swiss discovery procedures to this case. Counsel's persistence in resisting discovery on the basis of Defendants' immunity under Swiss law delayed the production of documents and gave Defendants the opportunity to destroy documents.

36. Counsel advised their clients that the May Order was not applicable to Defendants' competition with GES so long as Defendants compete behind the mask of Biosphere, a point never refuted by counsel despite the opportunity. Since Defendants are virtually the sole officers, shareholders and employees of Biosphere, counsel's advice is highly contemptuous of this Court's rulings and perpetuates the Defendants' efforts to avoid liability through shell corporations.

37. Additionally, in filing Document A7077 under seal and withholding it from Plaintiff, defense counsel represented that the trade secrets issue could be decided

on the basis of the contents of Document A7077. At the hearing on November 26, 1991, defense counsel attempted to minimize the significance of Document A7077 and its predecessors. The willingness of defense counsel to manipulate and fabricate facts to sustain whatever their current position might be is evidence of their bad faith.

38. Defense counsel's behavior even after the November 26, 1991 hearing demonstrates bad faith. Although counsel was in receipt of the alleged predecessors to Document A7077 on December 2, 1991 defense counsel did not make those documents available to Plaintiff or advise Plaintiff of the existence of such documents until 5:43 P.M. on Friday, December 6, 1991. Furthermore, defense counsel did not advise Plaintiff's counsel of the nature of such documents.

39. Counsel's assistance in obstructing discovery is particularly offensive given the fact that defense counsel represented Defendants and reviewed the documents whereby Biosys terminated its contract with GES in May 1990. Had defense counsel just been retained for this lawsuit their claims of good faith might have had more credence. However, because defense counsel were involved at the outset of the alleged scheme, well before the complaint was ever filed, they had every opportunity to assure timely discovery and the preservation of records. Instead, defense counsel has, at every opportunity, resorted to whatever tactic is accommodative to delay this case, including attempts to trivialize Defendants' destruction of discoverable records.

40. Defense counsel's principal response to questions about Defendants' failure to provide discovery has been to claim that Plaintiff has no case on the merits. Counsel should be well aware that perceived weaknesses in an opponent's case are no justification for repeated violations of court orders.

> Such a position is intolerable. Plaintiff is entitled to try to prove his case no matter what Defendant may think of it, and Defendant is therefore obliged to provide Plaintiff with responses to his discovery requests. To even suggest that Defendant's opinion of Plaintiff's case should have any bearing upon the discovery process demonstrates willful disregard for the responsibilities Defendant owes the court and his opponents.

Monroe v. Ridley, 135 F.R.D. 1, 5 (D.D.C. 1990). Defendants raise this argument to distract from their own behavior and to take advantage of their destruction of documents related to the trade secret issue.

41. Federal Rule 37 and the inherent power of this court authorizes the award against Defendants and their counsel of attorney fees and expenses incurred by Plaintiff to date in this lawsuit. The actions of Defendants and their counsel were unreasonable under all circumstances. Rather than attempt to cooperate and bring this case to trial, Defendants and their counsel insisted on obstructing these proceedings repeatedly.

CONCLUSION

For the reasons stated herein, Plaintiff's Renewed Motion for Sanctions is granted. Plaintiff is granted a

default judgment on its complaint and Defendant Biosys's counterclaim is dismissed. As a further sanction, Defendants and their counsel are ordered to pay Plaintiff all of the attorney fees and costs incurred by Plaintiff in this case. All other motions are dismissed as moot. A trial on the issues of damages will be commence [sic] on April 14, 1992 at 10:00.

IT IS SO ORDERED.

[Published and Cited as 800 F. Supp. 1497 (N.D. Ohio 1992)]

GENERAL ENVIRONMENTAL SCIENCE CORPORATION,

Plaintiff,

v.

Frank L. HORSFALL, et al., Defendants.

No. 1:90 CV 1340.

United States District Court, N.D. Ohio, E.D.

May 29, 1992.

Corporation that sold live liquid microorganism used to treat, inter alia, waste-water and aquarium water filed complaint against former European distributors, alleging theft of trade secrets, violation of RICO (Racketeer Influenced and Corrupt Organizations Act), breach of non-compete provision, defamation, and various other state tort claims. After entry of default judgment on issue of liability and dismissal of counterclaims and following hearing on issue of damages, attorney fees, and costs, the District Court, Battisti, J., held that: (1) defendants were liable under RICO and Ohio Corrupt Activities Act for nearly $4 million in compensatory damages, representing treble the amount of unpaid product, lost profits, and consequential damages; (2) under Ohio law, defendants were also liable for $7.9 million in punitive damages, representing twice the amount of their compensatory damages, based on their complete and callous disregard for the truth, for seller, and for judicial system; and (3)

seller was also entitled to attorney fees and costs in excess of $268,000.

Judgment accordingly.

Jerome F. Weiss, William T. Davis, Weiss, Neiditz and Associates, Cleveland, Ohio, for plaintiff.

Stephen D. Walters, Jason T. Blackford, Thomas C. Buford, Weston, Hurd, Fallon, Paisley & Howley, Cleveland, Ohio, for defendants.

ORDER

BATTISTI, District Judge.

This case came before the Court for a hearing on April 21, 1992, on the issue of damages, attorney fees and costs. Based upon the evidence and argument presented at the hearing, together with such evidence already of record in this case, the Court makes the following findings of fact and conclusions of law.

FINDINGS OF FACT

1. General Environmental Science Corporation ("GES") is a corporation headquartered in Cleveland, Ohio which sells live-liquid micro organism ("LLMO"). The product is sold in the United States and around the world, and is used to treat waste water and aquarium water, among other things. GES also developed and owned a technology known as an on-site activation system. (Transcript of Hearing held April 21, 1992 ("Hearing Trans.") at 12-13, 75).

2. Beginning in about 1988, GES began selling its LLMO product in Europe through Frank Horsfall ("Horsfall") and John Strauss ("Strauss").

3. Between August 1989 and December 1989, Defendants confided in Karl Ehrlich ("Ehrlich") that they

> were entering a contract for distribution with GES that they never intended to honor, and that they planned in the future to break this contract as soon as they could set up their own production facilities and that the [sic] would use product variability and potency as a basis for breaking the contract and competing.

(Ehrlich Affidavit at ¶ 8).

4. In November 1989, Biosys Corporation[1] ("Biosys"), which is owned and controlled by Strauss, Horsfall, and Gustavo Gysler ("Gysler"), signed a contract with GES to be its European distributor of LLMO. (Hearing Trans. at 13-14; Verified Complaint at ¶ 14).

5. On or about May 4, 1990, Defendants terminated their relationship with GES, citing product variability and potency (Verified Complaint at ¶ 16). On that same day, Defendants formed a new corporation called Biosphere, S.A.

6. Defendants confirmed the termination of their relationship with GES on May 15, 1990 and began competing with GES.

7. On July 27, 1990, GES filed a complaint against Gysler, Horsfall, Strauss, and Biosys alleging theft of

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[1] Biosys was formerly known as X-O Corporation.

trade secrets, violation of RICO, breach of non-compete provisions, defamation and various other state tort claims. GES sought actual damages in the amount demonstrated by the evidence, as well as treble damages under RICO and the Ohio Corrupt Activities Act, punitive damages under state law, attorney fees and costs, and injunctive relief.[2]

8. On March 10, 1992, 141 FRD 443, the Court entered a default judgment as to liability against Defendants and dismissed the counterclaim of Biosys with prejudice pursuant to Rule 37(b)(2) of the Federal Rules. The counterclaims of Strauss and Horsfall were dismissed with prejudice on April 7, 1992. As a further sanction, Defendants and their counsel were ordered to pay all of the attorney fees and costs incurred by Plaintiff in this case.

9. On April 21, the Court held a hearing on the issue of damages, attorney fees and costs.

10. GES presented the following evidence: (1) testimony of GES President Barton Gilbert; (2) affidavit of

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[2] In its Verified Complaint, GES prayed for the following damages:

1) Actual damages of at least $41,214.50 and such further damages as the evidence may show, trebled as provided for in 18 U.S.C. § 1964(c), and R.C. § 2923.34;
2) Punitive damages in the amount of not less than $10,000,000.00;
3) [request for injunctive relief]
4) [request for declaratory relief]
5) Expenses and an award of attorney fees;
6) Interest and costs; and
7) Such other relief as the Court deems appropriate.

economist John Burke, Ph.D.; (3) exhibits pertaining to GES product ordered by Defendants but never paid for; (4) references to the Gysler's deposition testimony; (5) affidavit of Barton Gilbert as to attorney fees, costs and other economic damages; (6) affidavits of counsel Jerome F. Weiss, Esq., William T. Davis, Esq., Niki Z. Schwartz, Esq., and Richard L. Stoper, Esq., as to attorney fees and costs; and (7) affidavit of Karl F. Ehrlich.

11. Defendants, represented by counsel, presented no evidence other than references to the transcript of Gysler's deposition.

12. Stephen Walters, Esq., Thomas C. Buford, Esq., and Jason C. Blackford, Esq. were present for all or part of the hearing and presented no evidence. The law firm of Weston, Hurd, Fallon & Paisley was represented by counsel at the hearing, but presented no evidence.

13. Specifically, GES seeks damages for (1) product ordered and shipped but not paid for; (2) lost profits on European sales of LLMO; and (3) lost revenues resulting from Defendants' use of GES's on-site activation system technology.

14. Defendants ordered and received LLMO product from GES totaling $41,214.50. Defendants never reimbursed GES for these items. (Hearing Trans. at 44; Hearing Exhibit 4).

15. GES has been unable to re-establish its business in Europe as a result of Defendants' illegal competition, Defendants' theft of customers with whom they had primary contact as a distributor, and this lawsuit. (Hearing

Trans. at 41). GES has been unable to re-establish a distribution network. *Id.* at 43.

16. GES presented evidence of its historical sales of LLMO in Europe to establish its lost profits. GES sales of LLMO in Europe increased from $17,339 for the year May 15, 1985 through May 15, 1986, to $173,334 for the year May 15, 1989 to May 15, 1990.[3] During this period, GES sales in Europe grew at an annual compounded growth rate of nearly 78 percent. *Id.* at 23.

17. During the year after Defendants began the unlawful activity alleged in the complaint, GES sales in Europe fell to $44,635. Sales for the year May 15, 1991 to present fell further to $32,308. *Id.* at 24.

18. GES presented the affidavit of John F. Burke, Jr. ("Dr. Burke"), Associate Professor of Economics at Cleveland State University. Dr. Burke has an M.A. and Ph.D. in Economics from the University of Notre Dame and has been an associate professor at Cleveland State University since 1970. Dr. Burke has been the recipient of several awards, is a member of several professional organizations, and has authored several articles and papers. Dr. Burke has also presented testimony to several legislative bodies.

19. In preparing his affidavit, Dr. Burke reviewed "industrial data available from Dunn & Bradstreet Credit Services and actual financial statements of [GES] from the fiscal year ending 1987 through the month ending August

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[3] A May-to-May year was used because Defendants began competing with GES in May.

31, 1991, including actual sales history in Europe." (Burke Affidavit at ¶ 3).

20. Based on his review of this data, Dr. Burke projected potential lost sales suffered by GES as a result of the activities alleged in the Verified Complaint and the lost sales already demonstrated by the record of GES sales.

21. In projecting lost sales, Dr. Burke assumed that actual sales would "catch up" to projected sales by 1996. *Id.* at ¶ 9.

22. Dr. Burke projected sales at three different rates: (1) 30 percent which was the average annual growth rate set forth by GES and Biosys in their 1989 contract in order to permit the parties to renew the contract from year to year; (2) 77.8 percent which was the historical annual growth rate for GES's sales in Europe; and (3) 50 percent which was a midpoint between the first and second rates. *Id.* at ¶¶ 8, 10.

23. Based on his review and analysis of GES's financial statements, Dr. Burke determined that GES's average contribution margin on sales between 1987 and 1991 was 68.29 percent. The contribution margin is calculated by subtracting the variable costs from the total sales. The resulting contribution margin indicates the percentage of each sale which then contributes toward payment of fixed costs or, if such costs have been covered, constitutes profit. *Id.* at ¶ 11.

24. Burke testified that "[i]n this case, the contribution margin equates with profits because all the fixed

costs associated with this level of production have been covered." *Id.* at ¶ 12.

25. Based on an annual growth rate of thirty percent, Dr. Burke determined that GES would suffer lost profits of $923,661 prior to 1996 when it was assumed actual sales would catch up with projected sales. *Id.* at ¶ 13.

26. Based on an annual growth rate of 77.8 percent, Dr. Burke determined that GES would suffer lost profits of $3,081,263 prior to 1996 when it was assumed actual sales would catch up with projected sales. *Id.* at Table 16.

27. Based on an annual growth rate of fifty percent, Dr. Burke determined that GES would suffer lost profits of $1,572,505 prior to 1996 when it was assumed actual sales would catch up with projected sales. *Id.* at ¶ 13.

28. GES also seeks damages from Defendants' use of GES's trade secrets relating to an on-site activation system for microbiological products, which GES had developed but not marketed in Europe. Defendants marketed this technology in Europe under the name "Systems on Site" or "SOS". Since GES never marketed the on-site activation system in Europe, it has no sales or profit figures from which to calculate lost sales or profits.

29. Defendants, as documented in this Court's orders of April 4, 1991, May 24, 1991 and March 10, 1992, have refused to produce some of their business records and most of their financial records pertinent to the issues before the Court. Accordingly, Defendants' revenues, sales and/or profits from use of the on-site activation

technology cannot be confirmed beyond the sworn deposition testimony of Gysler, the administrator or chief executive of both Biosys and Biosphere.

30. Gysler testified that Defendants had entered into, or were on the verge of entering into, contracts with customers in France, England, and Spain. Gysler also testified that Biosphere has not made any profit in any area of waste water treatment. (Gysler Depo. at 428-29). GES contends that these contracts would have generated over five million dollars annually. (*See* GES' Memorandum on Damages at 19). GES based its calculation on Gysler's testimony concerning Defendants' anticipated income.

31. The figures GES relies on represent anticipatory amounts of income and are speculative in nature. However, GES has established that Defendants entered into a contract with Bio Abengoa providing them 650,000 Swiss francs[4] and a 12% royalty. (Gysler Depo. at 170, 583).

32. GES submitted affidavits of its counsel documenting the following fees and costs incurred in the litigation of this lawsuit:

Fees of Jerome F. Weiss, Esq.	$143,412.25
Expenses of Jerome F. Weiss & Associates	5,813.51
Morse, Gantverg & Hodge	19,735.90
Fees of William T. Davis, Esq.	23,050.00
Fees of Niki Z. Schwartz, Esq.	44,625.00
Expenses of Gold, Rotatori, Schwartz & Gibbons	11,169.32

[4] $426,660 in American dollars based on the currency exchange rates on April 15, 1992.

Fees of Richard L. Stoper, Jr., Esq.	41,531.25
Total	$289,337.23[5]

(See Exhibit E to GES's Memorandum on Damages and Supplemental Affidavit to Plaintiff's Memorandum on Damages). The hourly rates charged were not objected to and were previously approved by the Court in the award of fees and costs ordered on October 10, 1991.

33. GES has also submitted the affidavit of Barton Gilbert documenting the following additional attorney fees and costs.

Eric Stoudmann, Esq.	$17,750.00
Records Deposition Service	217.85
Dr. Richard Graham	1,000.00
Case Western Reserve University	950.00
Original Copy Centers	644.50
Morse, Gantverg & Hodge	75.00
DocuCopy Management	1,012.31
Mehler & Hagestrom	1,272.50
Birdie Thaler	450.00
Total	$23,372.16

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34. In addition, the affidavit of Barton Gilbert reflects expenses of $12,160.52 for trips to Europe in connection with this litigation and expenses of $49,560.00 for time spent by GES employees in connection with this lawsuit.

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[5] This amount includes the $44,424.75 in attorney fees and costs which Defendants were ordered to pay as a sanction for discovery abuses.

35. Any Conclusion of Law deemed a Finding of Fact is incorporated herein.

CONCLUSIONS OF LAW

1. Any Finding of Fact deemed a Conclusion of Law is incorporated herein.

2. Upon default judgment, " 'the factual allegations of the complaint, except those relating to the amount of damages, will be taken as true.' " *Comdyne I, Inc. v. Corbin*, 908 F.2d 1142, 1149 (3d Cir.1990) (quoting 10 Charles A. Wright, Arthur R. Miller & Mary K. Kane, *Federal Practice & Procedure*, § 2668 at 444 (2d ed. 1983) (citation omitted)). "As a general rule, a 'default judgment establishe[s], as a matter of law, that defendants [are] liable to plaintiff as to each cause of action alleged in the complaint.' " *Dundee Cement Co. v. Howard Pipe & Concrete Prods., Inc.*, 722 F.2d 1319, 1323 (7th Cir.1983) (quoting *Breuer Electric Mfg. Co. v. Toronado Sys. of Am., Inc.*, 687 F.2d 182, 186 (7th Cir. 1982)).

3. "A default judgment . . . does not establish the amount of damages." *United States of Am. for the Use of M-CO Constr., Inc. v. Shipco Gen., Inc.*, 814 F.2d 1011, 1014 (5th Cir.1987) (citations omitted).

4. "Damages may be awarded only if the record adequately reflects the basis for award via 'a hearing or demonstration by detailed affidavits establishing the necessary facts.' " *Adolph Coors Co. v. Movement Against Racism*, 777 F.2d 1538, 1544 (11th Cir.1985) (citation omitted).

5. Damages awarded following entry of a default judgment "shall not be different in kind from or exceed in

amount that prayed for in the demand for judgment." Rules 54 and 55 of the Federal Rules. GES prayed for "[a]ctual damages of at least $41,214.50 *and such further damages as the evidence may show.*" Therefore, GES is entitled to seek damages beyond the $41,214.50.

6. The measure of damages under RICO is "the harm occasioned as a result of the predicate acts of the offenders. A Plaintiff injured by civil RICO deserves a 'complete recovery.' " *Fleischauer v. Feltner,* 879 F.2d 1290, 1299-1300 (6th Cir.1989), *cert. denied,* 493 U.S. 1074, 110 S.Ct. 1122, 107 L.Ed.2d 1029, *cert. denied,* 494 U.S. 1027, 110 S.Ct. 1473, 108 L.Ed.2d 611 (1990) (citations omitted). These damages must be "established by competent proof, not based upon mere speculation and surmise." *Id.* at 1299.

7. GES is entitled to recover damages suffered in its "business or property." 18 U.S.C. § 1964(c). As a result of Defendants' failure to pay for product ordered from GES, GES suffered damages of $41,214.50.

8. Although the Sixth Circuit has not addressed the issue of the recovery of lost profits under RICO, other district courts have allowed their recovery. *See Sound Video Unlimited, Inc. v. Video Shack, Inc.,* 700 F.Supp. 127 (S.D.N.Y. 1988); *DeMent v. Abbott Capital Corp.,* 589 F.Supp. 1378 (N.D. Ill.1984). In *DeMent,* the court held that "[i]f the 'damages sustained' by a victim of a RICO violation include lost profits, we see no bar in the statute to recovery of those losses. Of course, recovery of lost profits should be subject to the ordinary limitations concerning remoteness (or proximate cause) and speculativeness (or certainty)." *DeMent,* 589 F.Supp. at 1386. The

Court adopts this reasoning. Furthermore, lost profits are recoverable under Ohio law for the predicate acts. *See Premix, Inc. v. Zappitelli*, 561 F.Supp. 269 (N.D.Ohio 1983) (employee's breach of restrictive covenant); *Wiebold Studio, Inc. v. Old World Restorations, Inc.*, 19 Ohio App.3d 246, 484 N.E.2d 280, 287 (1985) (theft of trade secrets).

9. The principal factual basis for damages alleged in the complaint is the damages suffered by GES as a result of Defendants' theft of trade secrets and use of such trade secrets for their own profit.

> There are two basic methods for assessing damages for misappropriation of trade secrets: one, the damages sustained by the victim (the traditional common law remedy), and the other, the profits earned by the wrongdoer by the use of the misappropriated material (an equitable remedy which treats the wrongdoer as trustee *ex maleficio* for the victim of the wrongdoer's gains from his wrongdoing). Ordinarily a plaintiff may recover either, but not both, because to allow both would permit double recovery. Since the objective in allowing damages is to compensate the plaintiff for the difference in his position before and after the misappropriation of his secret, his probable loss may be the more significant measuring rod than the misappropriator's actual gain.

Sperry Rand Corp. v. A-T-O, Inc., 447 F.2d 1387, 1392-93 (4th Cir.1971), *cert. denied*, 405 U.S. 1017, 92 S.Ct. 1292, 31 L.Ed.2d 479 (1972).

10. Although GES's loss cannot be calculated with mathematical certainty,

> [w]here the tort itself is of such a nature as to preclude the ascertainment of the amount of damages with certainty, it would be a perversion of fundamental principles of justice to deny all relief to the injured person, and thereby relieve the wrongdoer from making any amend for his acts. In such case, while the damages may not be determined by mere speculation or guess, it will be enough if the evidence show the extent of the damages as a matter of just and reasonable inference, although the result be only approximate. The wrongdoer is not entitled to complain that they cannot be measured with the exactness and precision that would be possible if the case, which he alone is responsible for making, were otherwise.

Story Parchment Co. v. Paterson Parchment Paper Co., 282 U.S. 555, 563, 51 S.Ct. 248, 250-51, 75 L.Ed. 544 (1931).

11. Normally, lost profits are defined as lost net profits. However, the Ohio Supreme Court has allowed recovery of lost gross profits, as equivalent to net profits, where the defendants failed to prove that additional expenses should have been deducted to derive net profits. *Digital & Analog Design Corp. v. North Supply Co.*, 44 Ohio St.3d 36, 540 N.E.2d 1358 (1989). Dr. Burke testified that all of GES's fixed costs were covered. Defendants have not offered any evidence to show that additional expenses should have been deducted. Therefore, GES's lost profits can be calculated by multiplying the lost sales by the contribution margin.

12. As a result of the conduct alleged in the verified complaint, GES has lost profits of $923,661 on past and future sales of LLMO in Europe. This calculation is based

on a five year recovery period and a projected annual growth of thirty percent. The five year recovery period is a reasonable estimate. Although this is not a contract action, an annual growth rate of thirty percent is reasonable given that Defendants and GES agreed in their 1989 contract that their relationship would continue if certain minimum annual purchases were met each year. The average annual increase in minimum sales required to renew the contract was about thirty percent.

13. GES is also entitled to compensation for Defendants' misappropriation of GES's on-site activation system technology, even though it has never been sold by GES in Europe. A plaintiff "may recover profits, even if he had not been manufacturing and would have been then unable to make the sales; and this is because he had a monopoly in the article itself." *G. & C. Merriam Co. v. Saalfield,* 198 F. 369, 376 (C.C.A.Ohio 1912).

14. GES has established that Defendants entered into a contract with BioAbengoa which generated $426,660. GES is entitled to recover the profits earned by Defendants. Although Gysler testified that Biosphere did not make any profits on waste water treatment, GES is entitled to recover the profits Defendants earned on this particular contract. Because Defendants have withheld their financial records and other documents, Defendants' profit margin cannot be determined. Defendants' [sic] will not be permitted to profit from their abuse of the discovery process. *See Story Parchment Co. v. Paterson Parchment Paper Co.,* 282 U.S. 555, 563, 51 S.Ct. 248, 250-51, 75 L.Ed. 544 (1931) ("The wrongdoer is not entitled to complain that [damages] cannot be measured with the exactness and precision that would be possible if the

case, which he alone is responsible for making, were otherwise.") Therefore, the Court will estimate Defendants' profit using GES's contribution profit. Accordingly, GES is awarded damages of $291,366.11 based on Defendants' theft of the GES on-site activation technology. Since the Court entered a permanent injunction on March 10, 1992, there is no need to award future damages.

15. GES has also been damaged in regards to amounts expended by GES to attempt to regain customers or save lost accounts. *Dozor Agency, Inc. v. Rosenberg*, 218 A.2d 583 (Pa.1966). Gilbert's affidavit documents to [sic] expenses of $12,160.52 for trips to Europe in connection with the matters alleged in the complaint. Furthermore, GES incurred expenses of $49,560.00 in connection with time spent by its employees in dealing with Defendants' actions.

16. GES's total compensatory damages are as follows:

Unpaid Product	$ 41,214.50
Lost Profits on LLMO	923,661.00
Lost Profits on On-Site Activation System	291,366.11
Consequential Damages	
-Travel	12,160.52
-Employee Time	49,560.00
Total	$1,317,962.13

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17. "Any person injured in his business or property by reason of a violation of section 1962 . . . shall recover threefold the damages he sustains and the cost of the suit, including a reasonable attorney's fee." 18 U.S.C.

§ 1964(c). "[I]mposition of treble damages is required by RICO." *MDO Dev. Corp. v. Kelly*, 735 F.Supp. 591, 593 (S.D.N.Y.1990). "RICO treble damages . . . are largely compensatory in the special sense that they ensure that wrongs will be redressed in light of the recognized difficulties of itemizing damages." *Liquid Air Corp. v. Rogers*, 834 F.2d 1297, 1310 n. 8 (7th Cir.1987), *cert. denied*, 492 U.S. 917, 109 S.Ct. 3241, 106 L.Ed.2d 588 (1989). Treble damages are also provided for by the Ohio Corrupt Activities Act. *See* Ohio Rev.Code § 2923.34(F). After trebling, GES's compensatory damages are $3,953,886.39.

18. Punitive damages may be awarded in a tort action when the plaintiff has suffered actual damages and where the acts and omissions of the defendant "demonstrate malice, aggravated or egregious fraud, oppression, or insult." Ohio Rev. Code § 2315.21(B).

19. Ohio courts have awarded punitive damages in trade secret cases "where the evidence shows that the defendant acted willfully and intentionally and with malicious intent." *Pyromatics, Inc. v. Petruziello*, 7 Ohio App.3d 131, 454 N.E.2d 588, 595 (1983) (citations omitted) (upholding award of punitive damages against employee who stole employer's trade secrets and then attempted to compete against him).

20. The Ohio Supreme Court has defined actual malice as "(1) that state of mind under which a person's conduct is characterized by hatred, ill will or a spirit of revenge, *or* (2) a conscious disregard for the rights and safety of other persons that has a great probability of causing substantial harm." *Preston v. Murty*, 32 Ohio St.3d 334, 512 N.E.2d 1174, 1173 (1987) (syllabus).

21. Defendants acted with "a conscious disregard for the rights" of GES. GES established, through Ehrlich's affidavit, that Defendants planned their actions in advance. Defendants became GES's European distributor, set up shell corporations, stole GES's trade secrets and then used them to compete against GES. Because Biosys was GES's sole European distributor, Defendants had primary contact with GES's customers. Thus, Defendants' scheme had the probable result of harming GES's business interests. Furthermore, Defendants' claims of product variability and potency also were calculated to harm GES's business interests. Then after GES brought suit, Defendants abused the discovery process, ignored Court orders, and violated the preliminary injunction. Defendants' misconduct during this litigation has been documented in previous court orders.

22. The purpose of awarding punitive damages is "to punish and deter conduct resulting from a mental state so callous in its disregard for the rights and safety of others that society deems it intolerable." *Calmes v. Goodyear Tire & Rubber Co.*, 61 Ohio St.3d 470, 575 N.E.2d 416, 419 (1991). The amount awarded should be no more and no less than that sufficient to achieve this purpose. *Villella v. Waikem Motors, Inc.*, 45 Ohio St.3d 36, 543 N.E.2d 464, 477 (1989) (Wright J., concurring).

23. The Court "has considerable discretion in fixing damages. The factors to be considered are (1) the nature of the defendants' acts; (2) the amount of compensatory damages awarded; and (3) the wealth of the defendants." *Professional Seminar Consultants, Inc. v. Sino Am. Tech. Exch. Council, Inc.*, 727 F.2d 1470, 1473 (9th Cir.1984).

24. Defendants have shown a complete and callous disregard for the truth, for GES and for the judicial system. To punish them and deter others from engaging in such conduct, GES is awarded punitive damages in the amount of twice their compensatory damages. This amount is reasonable considering the nature and scope of Defendants' actions and the amount of compensatory damages awarded. Because Defendants have failed to produce financial records, the effect of this award of punitive damages cannot be measured against Defendants' wealth. However, Defendants cannot escape the imposition of punitive damages by withholding documentation of their financial status.

25. Defendants and their counsel were ordered to compensate GES for its attorney fees and expenses incurred in this action. GES and its counsel have itemized these expenses and attorney fees. Their rates are reasonable for the level of skill and experience of Plaintiff's counsel and considering complex issues raised by RICO and several issues of foreign law raised by the Defendants. Accordingly, $268,284.64 in fees and costs are assessed jointly and severally against Defendants and their counsel, Jason Blackford, Thomas C. Buford, Stephen Walters.

26. All other motions are dismissed as moot.

CONCLUSION

GES has proved actual damages of $1,317,962.13. After trebling as provided by 18 U.S.C. § 1964, the damages of GES are $3,953,886.39. Punitive damages of $7,907,772.78 are awarded. Thus, Defendants are jointly

and severally ordered to pay GES $11,861,658.17 in damages.

Attorney fees and costs of $268,284.64 are awarded jointly and severally against Defendants and their counsel, Jason Blackford, Thomas Buford, and Stephen Walters. Defendants remain obligated to pay $44,424.75 in attorney fees previously awarded.

IT IS SO ORDERED.

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

GENERAL ENVIRONMENTAL SCIENCE CORPORATION, Plaintiff, vs. FRANK L. HORSFALL, et al. Defendants. Battisti, J.	Case No. 1:90 CV 1340 ORDER (Filed Sep. 16, 1992)

Before the Court are Attorneys Jason Blackford, Thomas Buford and Stephen Walters' Motions to Amend or Alter Judgment and for a New Trial and Plaintiff General Environmental Science's Motion to Amend Judgment. The Court held a hearing on these motions on July 17, 1992. For the reasons stated below, the attorneys' motion to amend or alter the judgment is granted.

While the "factual" representations and arguments of law made by or on behalf of the attorneys leave much to be desired, the Court has reconsidered its decision to hold them jointly liable for all of Plaintiff's attorneys fees. As egregious and sanctionable as their conduct was, the Court nonetheless, on reconsideration of the exercise of its discretion, has decided to vacate the part of its March 10, 1992 Order holding them jointly and severally liable for all of Plaintiff's attorney fees. Defendants, the principal culprits, remain liable for Plaintiff's damages and attorneys fees. However, the attorneys are warned that they are to conduct themselves uprightly, and that when

ethical concerns arise, the Court should be approached in an appropriate manner.

IT IS SO ORDERED.

/s/ Frank J. Battisti
Frank J. Battisti
United States District Judge

Nos. 92-4110/11/12/13/14

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

GENERAL ENVIRONMENTAL SCIENCE CORPORATION, Plaintiff-Appellee/Cross-Appellant, v. FRANK L. HORSFALL; JOHN L. STRAUSS; BIOSYS CORPORATION; GUSTAVO GYSLER, Defendants-Appellants, STEPHEN WALTERS, JASON C. BLACKFORD. THOMAS C. BUFORD, Cross-Appellees.	ORDER (Filed July 11, 1994)

BEFORE: MILBURN and GUY, Circuit Judges; and BROWN, Senior Circuit Judge.

The court having received a petition for rehearing en banc, and the petition having been circulated not only to the original panel members but also to all other active judges of this court, and no judge of this court having requested a vote on the suggestion for rehearing en banc, the petition for rehearing has been referred to the original hearing panel.

The panel has further reviewed the petition for rehearing and concludes that the issues raised in the

petition were fully considered upon the original submission and decision of the case. Accordingly, the petition is denied.

ENTERED BY ORDER
OF THE COURT

/s/ Leonard Green
Leonard Green,
Clerk pe

(2)

Supreme Court, U.S.
FILED
SEP 21 1994
OFFICE OF THE CLERK

No. 94-339

In The

Supreme Court of the United States

October Term, 1994

GENERAL ENVIRONMENTAL SCIENCE CORP.,

Petitioner,

vs.

FRANK L. HORSFALL, BIOSYS CORPORATION, GUSTAVO GYSLER, STEPHEN WALTERS, JASON C. BLACKFORD, THOMAS C. BUFORD,

Respondents.

Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit

BRIEF IN OPPOSITION OF RESPONDENTS STEPHEN WALTERS, JASON C. BLACKFORD AND THOMAS C. BUFORD

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BRIEF IN OPPOSITION OF RESPONDENTS STEPHEN WALTERS, JASON C. BLACKFORD AND THOMAS C. BUFORD

To The Honorable Supreme Court:

Respondents Stephen Walters, Jason C. Blackford and Thomas C. Buford respectfully request that the Court deny the Petition for a Writ of Certiorari submitted by Petitioner.

OPINIONS BELOW, JURISDICTION, AND STATUTES AND RULES

These respondents accept petitioner's identification as to Opinions Below, Jurisdiction of the Court and Statutes and Rules Involved.

STATEMENT OF THE CASE

On July 27, 1990, petitioner General Environmental Science Corp. filed, in the United States District Court for the Northern District of Ohio, Eastern Division, a complaint against respondents Frank L. Horsfall, John L. Strauss, Gustavo Gysler and Biosys, S.A. (hereinafter referred to as "defendants"), alleging theft of trade secrets and other tortious acts. Defendants retained the law firm of Weston, Hurd, Fallon, Paisley and Howley to represent them. Respondents Jason C. Blackford, Stephen Walters and Thomas C. Buford (hereinafter referred to as "the defendants' attorneys") were attorneys at Weston, Hurd who, at various times, were assigned to the case.

Although defendants Horsfall, Gysler, et al., produced over seven thousand (7,000) documents in response to petitioner's discovery requests, and although defendant Horsfall was deposed for eight (8) days, defendant Strauss was deposed for three (3) days and defendant Gysler was deposed for four (4) days – a total of over 3,500 pages of deposition testimony – petitioner filed repeated motions for discovery sanctions against the defendants. Ultimately, one of those motions was granted by the District Court: on March 10, 1992, the Court issued an Order granting a default judgment against defendants pursuant to Rule 37(b) (2) (C) of the Federal Rules of Civil Procedure. (App. 122). "As a further sanction," the District Court ordered "Defendants *and their counsel*" to "pay plaintiff *all of the attorney fees* and costs incurred by Plaintiff *in this case.*" (App. 123).

Subsequently, on May 29, 1992, the District Court entered a default judgment against the defendants in the amount of $11,861,658. In addition, the District Court determined that plaintiff's attorney fees and costs since the inception of the case aggregated $268,284, and entered judgment against defendants *and their attorneys* in that amount.

The defendants' attorneys then retained their own counsel, who on June 8, 1992, filed a Motion to Amend or Alter Judgment, pursuant to Rule 59(e). On September 16, 1992, after having received affidavits from the attorneys and after having held an oral hearing on the Rule 59(e) Motion, the District Court entered an Order stating that "on reconsideration of the exercise of its discretion," it had decided to "vacate the part of its March 10, 1992

Order holding [the attorneys] jointly and severally liable for all of Plaintiff's attorney's fees." (App. 144).

The defendants then appealed from the default judgments that had been entered against them on May 29, and the plaintiff (petitioner herein) appealed from the District Court's order of September 16, which vacated the $268,284 judgment that had been entered against the attorneys.

On May 25, 1994, the Sixth Circuit vacated the default judgments that had been entered against the defendants, holding that the imposition of "ultimate sanctions" was not warranted. Nevertheless, the Sixth Circuit stated that its decision

> should not preclude the district court from considering whether lesser sanctions still should be imposed, or from reconsidering, in the event of subsequent abuses, whether a default judgment may yet be warranted. (App. 28).

With respect to plaintiff-petitioner's appeal, the Sixth Circuit held that petitioner had failed to demonstrate that the District Court had abused its discretion when, on September 16, 1992, it vacated the judgment it had entered against the defendants' attorneys on May 29. The Sixth Circuit further held that even if the District Court had *not* vacated its sanctions judgment against the attorneys, the appellate court would have been "compelled" to do so on the ground that it was in violation of the provisions of Rule 37. (App. 38).

SUMMARY OF ARGUMENT

This case involves no novel question of law nor any important question of federal law or procedure. With

respect to these respondents (defendants' attorneys), the Sixth Circuit merely held that the petitioner had failed to establish that the District Court abused its discretion when it ultimately decided *not* to impose monetary sanctions against the attorneys. In addition, the initial judgment that the District Court had entered against the attorneys was contrary to Rule 37 in several respects, any one of which errors would have mandated reversal by the appellate court had the District Court itself not vacated that judgment.

ARGUMENT FOR DENIAL OF THE WRIT

I. THE PETITIONER HAS FAILED TO PRESENT A VALID REASON FOR THIS COURT TO GRANT A WRIT OF CERTIORARI.

A. The Issue Before The Sixth Circuit Was Entirely Factual, i.e., Whether The District Court Abused Its Discretion When It Vacated The Monetary Sanctions It Had Earlier Imposed Against The Three Defense Attorneys.

This case presents no novel question of law nor any important question of federal law or procedure. The decision of the Sixth Circuit does not conflict with the decision of another court of appeals on the same matter. Notwithstanding petitioner's false and hyperbolic characterization of the Sixth Circuit's unanimous decision as "an attempt by a Court of Appeals to legislate new standards for the application of discovery sanctions," the Sixth Circuit simply followed established criteria for determining whether an abuse of discretion had occurred. The ultimate holding of the Sixth Circuit was

that, under this particular set of facts, the District Court *had not abused its discretion* when it ultimately decided to refrain from imposing monetary sanctions against the respondent attorneys (whose behalf this Brief is being filed), but that it *did* abuse its discretion when it entered a $12,000,000 default judgment against the respondent defendants.

Thus, the Order of September 16, 1992, that *petitioner appealed from* in the court below was an order in which the District Court expressly stated that "on reconsideration of the exercise of its discretion," it had decided to "vacate the part of its March 10, 1992 order holding [the defendants' attorneys] jointly and severally liable for all of plaintiff's attorney's fees." (App. 144). The Sixth Circuit therefore concluded that, in order to overturn the September 16 Order, petitioner had to "persuade the court [of appeals] that *an abuse of discretion* had occurred." (App. 35).

Petitioner failed to persuade the Court of Appeals that such an abuse had occurred, and understandably so.

B. The Evidence Was Insufficient To Establish An Abuse Of Discretion By The District Court.

In its opinion, the Sixth Circuit reviewed the rather extraordinary series of events that had occurred in the District Court and which demonstrated why the District Court had not abused its discretion in vacating the sanctions judgment it had previously entered against the attorneys.

For example, although defendants Horsfall, Gysler, et al., produced over seven thousand (7,000) documents in response to petitioner's discovery requests, and although defendant Horsfall was deposed for eight (8) days, defendant Strauss was deposed for three (3) days and defendant Gysler was deposed for four (4) days – a total of over *3,500* pages of deposition testimony – *petitioner filed repeated motions for sanctions* against the defendants. (See App. 7-14 for a description of these various motions, including the Sixth Circuit's observation, at App. 12, that the "fact that defendants' depositions took place as scheduled did not stop GES from renewing its motion from sanctions on August 27, 1991".)

Ultimately, the District Court notified the parties that a formal hearing on petitioner's "renewed motion for sanctions" would be held on November 26, 1991. On November 25, 1991, the day before the hearing, counsel for defendants received, in the mail, a lengthy "Supplemental Memorandum and Evidence of Defendants' Destruction of Documents in Support of Plaintiff's Renewed Motion for Sanctions." This Supplemental Memorandum claimed, *for the first time*, that a default judgment against the defendants was warranted because defendants had destroyed documents "which were the subject of formal discovery requests by" petitioner. In addition, the Supplemental Memorandum set forth a six-page "chronology of events" which purported to detail how Defendants had "delayed and obstructed discovery." Then, in the *last four pages* of its Supplemental Memorandum, petitioner suddenly turned its verbal guns against *the defendants' attorneys*, arguing that sanctions against them were "necessary and appropriate" because "counsel

has been implicated in this case from the very beginning"; that one of the attorneys had "met with defendants in May, 1990, and reviewed and approved their scheme which led to this entire case"; that counsel have engaged "in every possible obstructive discovery tactic"; that "defense counsel advised [their clients] that they could continue to compete with [plaintiff] in violation of the May 24, 1991 order if they did so as Biosphere"; that "counsel's withholding of document A7077 was clearly pretextual and for the sole purpose of inducing delay"; and that "counsel's delay and obstruction of discovery has permitted the destruction of relevant documents by the defendants." Significantly, none of these allegations against the defendants' attorneys were supported with any evidence. Instead, they rested almost entirely on the hyperbolic statements of petitioner's counsel.

As the Sixth Circuit pointed out in its Opinion, "defense counsel first learned of this latest salvo on November 25, 1991, the day before the scheduled hearing on GES's renewed motion." (App. 14). Defense attorney Walters immediately prepared a responsive "Supplemental Memorandum and Evidence of Defendants' Discovery Compliance" on behalf of his clients, which Supplemental Memorandum was filed late on the morning of November 26, the day of the hearing. In that Supplemental Memorandum, attorney Walters pointed out that "at this eleventh hour, with the Defendants thousands of miles away, counsel for Defendants cannot respond fully" to the new charges that had been made; maintained that his clients were *not* engaging in competition and were *not* "violating the [injunction] order [of May 24] through the non-party

Biosphere", as alleged in Plaintiff's Supplemental Memorandum; noted that, in response to the Court's discovery orders, defendants had provided over 7,000 documents to plaintiff and given over 3,500 pages of deposition testimony; maintained that defendant Gysler had *not* refused to answer questions "based on Swiss law," as alleged by petitioner; and declared that "no effort to destroy any evidence has been undertaken by defendants." In the final paragraph of this Memorandum attorney Walters made the following brief response to the unsupported accusations that had suddenly (and belatedly) been hurled against himself and his two partners, Blackford and Buford:

> Beyond the jingoistic notion permeating the Supplemental Memorandum that "Swiss" = "criminal", Plaintiff also attempts to drive a wedge between the Defendants and their counsel. The Court will note that there is absolutely no evidence offered by plaintiff of wrong-doing or the Court will note that there is absolutely *no evidence offered by Plaintiff* of wrong-doing or impropriety on the part of defense counsel. If plaintiff purports to have such evidence, let it come forward now or forever stop this slander.

The hearing on petitioner's Renewed Motion for Sanctions then proceeded on that same day. At the conclusion of the hearing, the District Court asked counsel for petitioner to submit proposed findings of fact and conclusions of law. On December 6 and 11, 1991, petitioner's counsel did so.

Three months later, on March 10, 1992, the District Court issued an order granting a default judgment against the defendants' pursuant to Rule 37(b)(2)(C). "As

a further sanction," the District Court ordered "Defendants *and their counsel*" to "pay plaintiff *all of the attorney fees* and costs incurred by Plaintiff *in this case.*" The basis for the sanctions against the defendants' attorneys was set forth in Conclusions of Law Nos. 35-39, which paragraphs closely tracked the allegations in the Supplemental Memorandum of petitioner that was received by defendants' attorneys the day before the November 26 hearing and the language of the proposed conclusions of law that had been submitted by petitioner's counsel on December 6 and 11, 1991. Essentially, those conclusions stated that defendants' attorneys had "continued to rely on Swiss discovery procedures to object to deposition questions, interrogatories and document requests;" that counsel had "advised their clients" that a certain injunction order was not applicable to a corporation that was not a party to the case; that "in filing document A7077 under seal," defense counsel had represented to the Court "that the trade secrets issue could be decided on the basis of the contents of Document A7077;" that although counsel had received "the alleged predecessors to Document A7077 on December 2, 1991, defense counsel did not make those documents available to plaintiff * *-* until Friday, December 6, 1991;" and that defense counsel "had every opportunity to assure timely discovery and the preservation of records."

Two months later, on May 29, 1992, the District Court found that petitioner's total attorney fees and costs *since the inception of the case* aggregated $268,284 (App. 132-133), and entered judgment against the defendants *and their attorneys* for that amount. (App. 143).

By that time the three defense attorneys (the respondents on whose behalf this Brief is being filed) had retained their own counsel. On June 28, 1992, counsel filed, pursuant to Rule 59(e), a motion to amend or alter the judgment that had been entered against those attorneys. That motion was supported by affidavits from each of the three attorneys. After petitioner filed a brief in opposition, the attorneys filed supplemental affidavits.

These affidavits, together with the written and oral arguments of the attorneys' counsel which pointed out, among other things, how the circumstances described above had prevented the attorneys from effectively defending themselves at the November 26, 1991 hearing, convinced the District Court that monetary sanctions against the three attorneys would be unjust. Accordingly, on September 16, 1992, the District Court entered an Order stating that "*on reconsideration of the exercise of its discretion*," it had decided to "vacate the part of its March 10, 1992 Order holding [the attorneys] jointly and severally liable for all of Plaintiff's attorney's fees." (App. 144).

Plaintiff (petitioner herein) then appealed the September 16 Order to the Sixth Circuit.

What petitioner would have this Court overlook – but which the Sixth Circuit did not – was that the issue on appeal was *not* the soundness of the District Court's "*initial* decision to award sanctions," but whether "an abuse of discretion had occurred" when the District Court *retracted* that initial decision. (App. 35). As indicated earlier, plaintiff-petitioner failed to persuade the Sixth Circuit that such an abuse of discretion had occurred. Stated the Court of Appeals (at App. 35-36):

> Indeed, in view of the affidavits submitted by defense counsel, we cannot conclude that this is an occasion in which a reversal of Judge Battisti's decision not to sanction is in order. Even if we were to subscribe to GES's view that Judge Battisti rejected defense counsel's post-judgment evidence, the question would still remain whether, at the time he issued his judgment, Judge Battisti could have justifiably reached the opposite conclusion. We feel that he could have, and accordingly, we reject GES's argument founded on Rule 37.

The Sixth Circuit also rejected petitioner's argument that the District Judge had no right to vacate his initial sanctions order so long as he continued to characterize the conduct of the three attorneys as "sanctionable." The Sixth Circuit pointed out that

> to determine that conduct is "sanctionable" is not to definitively resolve that sanctions must necessarily follow. To take the final step of actually imposing sanctions requires the exercise of discretion, only the abuse of which will cause this court to set aside the lower court's ruling. (App. 36, fn. 21)

This holding is fully consonant with the holdings of other circuits. See, for example, *Ingalls Shipbuilding, Inc. v. U.S.*, 857 F.2d 1448, 1450 (Fed. Cir. 1988), where the Federal Circuit held:

> The decision *whether to impose discovery sanctions* rests within *the sound discretion* of the trial court.

C. The Petitioner Has Misinterpreted Rule 37 And Its Application To This Case.

Notwithstanding the above-described holdings, petitioner argues that the District Court had no discretion, and that the assessment of attorney's fees against the attorneys was "mandatory," under Rule 37(b)(2). That Rule, however, provides that if a party fails to obey a discovery order, "the court in which the action is pending *may make such orders* in regard to failure *as are just.*" The rule then lists several examples of such orders, and concludes with the following paragraph:

> In lieu of any of the foregoing orders or in addition thereto, the court shall require the party failing to obey the order or the attorney advising that party or both to pay the reasonable expenses, including attorney's fees, caused by the failure, *unless the court finds that the failure was substantially justified or that other circumstances make an award of expenses unjust.*

Apart from its erroneous premises that Rule 37(b)(2) makes an assessment of attorneys fees "mandatory,"[1] petitioner's argument would have this Court ignore

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[1] At page 25 of its Petition, petitioner quotes 8 Wright & Miller, § 2289 at 792 as *supposedly* saying: "The rule now makes the award [of attorney fees] mandatory, regardless of what other sanctions may be imposed." However, petitioner's "quotation" is incomplete and therefore totally misleading. For what petitioner has done is to replace a comma with a period and completely jettison *the remainder of Wright & Miller's sentence,* which reads as follows: " . . . *unless* the delinquent party shows substantial justification for his failure or *other circumstances making an award unjust.*" 8 Wright & Miller, § 2289, p. 792.

entirely the italicized language. Petitioner's effort notwithstanding, it is manifest that, after considering all of the circumstances set forth in the attorneys' Rule 59(e) motion and supporting affidavits, the District Court concluded that the surrounding circumstances in this case were such as to "make an award of expenses unjust." Therefore, "on reconsideration of the exercise of its discretion," the District Court determined to vacate that portion of its prior order which imposed monetary sanctions against those attorneys. (App. 144).

To avoid this fact, petitioner blithely asserts that the "Sixth Circuit agreed that the district court had failed to find that the textural prerequisites had been met." (Petition, p. 24). In fact, no such statement is found anywhere in the Sixth Circuit opinion (which is why petitioner has supplied no page reference).

In short, petitioner's assertion that the Sixth Circuit's decision robs "Rule 37's mandatory award of attorney fees and costs [of] any meaning" is absolutely wrong, both in its premise and in its conclusion.

D. The Original Order Imposing Sanctions In The Amount Of $268,284 Against The Attorneys Was In Violation Of Rule 37 And Would Have Been Vacated By The Court Of Appeals Had The District Court Not Done So.

The original order of the District Court imposing sanctions against the attorneys in the amount of $268,284 was violative of Rule 37 in several key respects. Therefore, if the District Court had not vacated that order on

September 16, the Sixth Circuit would have been required to do so, as the Sixth Circuit's opinion makes clear.

First, the District Judge in this case *never concluded* that the attorneys had advised their clients to *disobey any discovery order.* This means that the fundamental prerequisite for monetary sanctions against those attorneys under Rule 37 – disobedience of a discovery order – never existed in this case.

Second, the judgment entered by the District Court against the attorneys on May 29, 1992 (which judgment was subsequently vacated on September 16, 1992) far exceeded the permissible scope of a monetary award under Rule 37(b)(2). The May 29, 1992 judgment compelled the attorneys to pay all of petitioner's attorney fees *for this entire litigation.* However, under Rule 37(b)(2) the only attorney fees that may be recovered are those that were "caused by the failure" of the sanctioned party to "obey" discovery orders. See *Batson v. Neal Spelce Associates, Inc.*, 765 F.2d 511, 516 (5th Cir. 1985), where the Fifth Circuit reversed an assessment of attorney fees under Rule 37 because the fees awarded included "discovery matters that were not related to Batson's failure to comply with the court's order." The "plain language of Rule 37", stated the Fifth Circuit, "provides that only those expenses, including fees, caused by *the failure to comply* may be assessed against the noncomplying party."

To the same effect is *Toth v. Trans World Airlines, Inc.*, 862 F.2d 1381, 1385-6 (9th Cir. 1988), stating that:

> Fed.R.Civ.P. 37(b)(2) provides for the award of reasonable expenses and attorney's fees "caused by the failure" to obey a court order to provide

> or permit discovery. Expenses incurred outside of this particular context are not provided for in Rule 37(b)(2).

Accord: Liew v. Breen, 640 F.2d 1047, 1051 (9th Cir. 1981), where the Court concluded that an award of fees incurred to obtain a court order was improper:

> Under Rule 37(b)(2), attorney's fees may be awarded for failure to *obey* a court order. The attorney-time before and during the May 17 hearing, in so far as it related to Breen, was to obtain a court order, and was not attorney-time incurred on account of Breen's failure to obey an order.

Therefore, in the instant case, the Sixth Circuit correctly concluded that this error by the District Court was, by itself alone, sufficient to warrant vacating the May 29, 1992 judgment:

> Judge Battisti failed to determine the amount of GES's attorneys' fees and costs directly attributable to defendants' and defense counsel's failure to obey court orders. Thus, even if we were to conclude that the trial judge erred by ultimately deciding against sanctioning defense counsel, *we still would be compelled to vacate his attorneys' fees award.* (App. 38).[2]

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[2] The original award also did not make any apportionment of responsibility between the attorneys and their clients, as required by Rule 37. See *Weisberg v. Webster*, 749 F.2d 864 (D.C. Cir. 1984), where the Court held that, under Rule 37, the trial court has to make such an apportionment, based on "how much responsibility is due to the client's recalcitrancies and how much to the lawyer's condonence or participation in the client's disobedience," and adequately explain that apportionment "by specific findings."

CONCLUSION

The instant case presents no issue of overriding public interest. Rather, the issue involved here is simply whether, under this particular set of facts, the Sixth Circuit erred in holding that the District Court did *not* abuse its discretion when that Court ultimately decided not to impose monetary sanctions against the three defense attorneys for all of the attorneys fees incurred by petitioner from the inception of this lawsuit. This Court should therefore deny the Petition for Writ of Certiorari.

Respectfully submitted,

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Supreme Court, U.S.
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(3)

No. 94-339

In The

Supreme Court of the United States

October Term, 1994

GENERAL ENVIRONMENTAL SCIENCE CORP.,

Petitioner,

vs.

FRANK L. HORSFALL, BIOSYS CORPORATION, GUSTAVO GYSLER, STEPHEN WALTERS, JASON C. BLACKFORD, THOMAS C. BUFORD,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court of Appeals For The Sixth Circuit

REPLY MEMORANDUM IN SUPPORT OF PETITION FOR CERTIORARI

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INTRODUCTION

On August 23, 1994, petitioner General Environmental Science Corp. filed a petition for certiorari seeking review of a decision of the U.S. Court of Appeals for the Sixth Circuit vacating a default judgment and other sanctions entered by the district court in a theft of trade secrets case. The district court had premised its decision on Federal Rule of Civil Procedure 37 and its inherent power as set forth by this Court in its recent decision in *Chambers v. NASCO, Inc.*, 501 U.S. 32 (1991). The "Questions Presented" by the petition included whether a district court properly vacates sanctions against attorneys whose conduct it finds to be "egregious and sanctionable" without finding that such conduct was "substantially justified" or that an award of sanctions would be "unjust" as required by Rule 37.

Defendant-respondents have made no response to the petition. A response was filed by counsel for the attorney-respondents.

"CORRECTIONS" TO RESPONDENTS' STATEMENT OF THE CASE

Respondents, in their statement of the case, attempt to relitigate the factual determinations made by the district court, none of which the Court of Appeals found to be clearly erroneous. The district court made extensive factual findings relating to the misconduct of defendants' and defense counsel which formed the basis for the sanctions imposed. The district court found among other things that:

1) Despite the entry of a Court Order on September 14, 1991, "Horsfall and Strauss refused to answer deposition questions, refused to answer interrogatories, and failed to produce documents on the ground that to do so would violate Swiss law." (App. 95);

2) Despite the entry of a Court Order on April 4, 1991 requiring defendants to appear for deposition and comply with all discovery requests, "*Defendants' counsel* refused to provide dates for the depositions and informed Plaintiff's counsel that Defendants would not appear for deposition as

noticed. Defendants also failed to produce any documents or interrogatory answers as ordered." (App. 98);

3) "Although *defense counsel* represented to the Court at the time that the delay was caused by the difficulty of communicating with their clients due to the distance between Switzerland and Cleveland, Gysler testified that the real reason for the delay was that 'we did not feel that we were obliged to obey the order according to Swiss law.' " (App. 98);

4) On May 15, 1991, after GES filed a motion to compel compliance with the April 4, 1991, order, the "Court warned *defense counsel* that further intransigence on Defendants' part could lead to the imposition of ultimate sanctions." (App. 99);

5) On May 24, 1991, the district court entered an Order finding that defendants had violated the April 4, 1991 Order and imposing a sanction of attorney fees incurred by GES in prosecuting its motion to compel (App. 99);

6) That same day, May 24, 1991, *defense counsel* filed with the court under seal, rather than produce to GES, a document known as A7077 which *defense counsel* claimed would demonstrate that defendants' products "differ in type and kind" from the products of GES, their former employer. (App. 99-101). *Defense counsel Walters later admitted in a post-judgment affidavit that he knew that document A7077 could not be withheld from GES and that he did so at the urging of his client, Gysler.*

7) "*Defense counsel* refused to disclose Document A7077 despite repeated requests by GES counsel. . . . " (App. 101);

8) Horsfall admitted destroying the predecessor documents to document A7077 during the period when such documents were the subject of discovery requests by GES and while *defense counsel* was resisting production of such documents in the district court. (App. 102);

9) The district court found that the destruction of documents was prejudicial to GES. (App. 103);

10) The district court found that "Defendants have ignored and violated Court Orders with impunity. Defendants

have refused to produce Court ordered discovery." (App. 110);

11) The district court found that "the destruction of those documents was the result of either a bad faith scheme to destroy such documents or an intentional indifference to their discovery obligations." (App. 110);

12) "The destroyed documents apparently were the only primary scientific data tracing the development of Defendants' product line which they used to compete with GES." (App. 111);

13) "Defendants' conduct is much more egregious than that a issue in *National Hockey League*." (App. 115);

14) "*Counsel for defendants* are just as culpable [as defendants.] They too have displayed a willingness to frustrate and obstruct court orders." (App. 120);

15) "*[Defense] [c]ounsel* continued to rely on Swiss discovery procedures to object to deposition questions, interrogatories and document requests, despite the September Order rejecting the applicability of Swiss discovery procedures. . . . *Counsel's* persistence in resisting discovery on the basis of defendants' immunity under Swiss law delayed the production of documents and gave Defendants the opportunity to destroy documents." (App. 120);

16) *Defense counsel* had no basis to withhold document A7077 from GES and "the willingness of *defense counsel* to manipulate and fabricate facts to sustain whatever their current position might be is evidence of their bad faith." (App. 121).

17) "*[D]efense counsel* has, at every opportunity, resorted to whatever tactic is accommodative to delay this case, including attempts to trivialize Defendants' destruction of discoverable records." (App. 121); and

18) The district court relied on its authority under Federal Rule 37 and its inherent power to award attorney fees against defendants and defense counsel. (App. 122) (emphasis added).

The district court entered its order of sanctions against defense counsel on March 10, 1992 and defense counsel

obtained counsel to represent their individual interests, including at a pretrial and damages trial. After a final judgment was entered, defense counsel filed a motion for new trial with affidavits claiming that their withholding of discovery was solely attributable to their clients.

Defense counsel were represented by Marvin Karp, of Cleveland, who argued that the district court had denied defense counsel due process by basing its decision on evidence as to which defense counsel had not been heard and did not have notice. When Mr. Karp learned that this position was contradicted by the record, he withdrew it.

Mr. Karp argued that defense counsel acted appropriately because they had an ethical duty to zealously represent their clients. He never explained why defense counsel did not try to withdraw as counsel when they learned of defendants' unscrupulous conduct, nor did he explain why defense counsel did not attempt to defend themselves in a filing under seal whereby they could maintain the interests of their clients yet not perpetrate their fraud on the district court.

At a hearing on defense counsels' motion for new trial, Mr. Karp essentially admitted defense counsels' misconduct and pleaded with the district court to exercise "extraordinary compassion" (Tr. at 2), and to "do what is fair and what is right," even if such is "against the popular and majority view." (Tr. at 8). The district court expressed no doubts about its decision to impose sanctions. "As I look back on this litigation I think that I really did throughout employ the utmost judiciousness and stretch my patience to the very end in this case." (Tr. at 56). Despite noting its aversion to awarding fees against attorneys, the district court reflected that "usually the first thing lawyers do when they realize they might have exceeded the bounds of professional responsibility is to purge themselves of the client. Nothing like that in this case happened." (Tr. at 57).[1]

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[1] Mr. Karp also essentially admitted the misconduct of defendant-respondents, misconduct which he now attempts to characterize as proper. "Now I am not here to argue on behalf of the named defendants in this case. Judgment is rendered

When a month passed and no relief was forthcoming from the district court, Mr. Karp wrote a letter to Judge Battisti advising that defense counsel wanted to express their regrets for their behavior and telling the court that they promised not to do it again. (Record Entry 317). GES responded and noted that defense counsels' regrets at having been caught did not compensate GES for the prejudice caused by defense counsels' abuse, nor would vacating the sanctions accomplish the deterrent effect which this Court referred to in the *National Hockey League* case.

On September 16, 1992, the district court entered a two-page order granting defense counsels' post-trial motion and vacating the award of attorney fees. The district court gave no explanation for the order, did *NOT* vacate any of its prior findings of fact or conclusions of law, and made no finding that defense counsel's conduct was "substantially justified" or that the award of fees against defense counsel would be unjust. *However,* the district court did take pains to emphasize that it did not credit the affidavits submitted by defense counsel with their post-judgment motion, and had not changed its opinion of their conduct. The district court reiterated that "the 'factual' representations and arguments of law made by or on behalf of the attorneys leave much to be desired," and that defense counsels' conduct was "egregious and sanctionable." The district court did not adopt any of the extensive findings submitted by defense counsel.

On appeal, GES argued that the district court, having found defense counsels' conduct to be "egregious and sanctionable," did not have the discretion to impose no sanction, without finding that the textual prerequisites set forth in Federal Rule 37 had been met.

The court of appeals affirmed Judge Battisti's exercise of compassion in favor of defense counsel despite characterizing his September 16 Order as "doublespeak." (App. 35). The

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against them and the Court does have a long fuse, and I was impressed with the patience the Court displayed as to what had happened with respect to the defendants in this case . . . " (Tr. at 54).

court of appeals suggested that the findings would be sufficient and "determinative" if Judge Battisti had refused to vacate the sanctions (App. 35), and that a mere finding that conduct was "sanctionable" did not require the imposition of any sanctions (id. at 36). The court of appeals also relied on the notice argument asserted by defense counsel in the district court and then later withdrawn or "corrected". (App. 37).

Defense counsel also suggest that sanctions were inevitable simply because GES filed "repeated motions for discovery sanctions," and the district court "[u]ltimately" granted one. In fact, the record will demonstrate that the district court granted a series of discovery motions filed by GES and gave each one careful consideration and made detailed findings on each. In fact, Mr. Karp praised Judge Battisti for his "patience" in the case. Without the motions, there would have been *no* discovery in this case.

I. THE ISSUE PRESENTED TO THIS COURT FOR REVIEW DOES NOT INVOLVE ANY ASSESSMENT OF FACTS OR REVIEW OF DISCRETION BUT IS THE STRICTLY LEGAL QUESTION OF WHETHER A DISTRICT COURT MAY VACATE AN AWARD OF SANCTIONS WHEN IT FINDS CONDUCT TO BE "EGREGIOUS AND SANCTIONABLE" WITHOUT FINDING, AS REQUIRED BY RULE 37, THAT THERE WAS ANY JUSTIFICATION FOR THE CONDUCT OR FINDING THAT AN AWARD OF SANCTIONS WOULD BE UNJUST.

In order to thwart review, defense counsel suggest that this case presents solely an issue of fact and not any issue of law which would guide other courts in their application of discovery sanctions. In short, defense counsel are wrong. The district court made findings of fact which the court of appeals found would be "determinative" and require affirmance if the district court had not vacated its judgment in response to Mr. Karp's pleas. The issue presented for review is the strictly legal issue of whether a district court which finds conduct to be egregious and sanctionable may refuse to impose sanctions

which he determines to be necessary without articulating any prerequisite under Rule 37 for withholding sanctions. Under defense counsels' view, every issue of sanctions would be a factual one, and the reversal by this Court in *National Hockey League* would have been precluded.

In addition, defense counsel suggest that GES has misled this Court by stating that an award of fees is mandatory under Rule 37. The authorities cited, the advisory notes and case law, confirm that an award of fees is mandatory. GES agrees with defense counsel, as it did in the court of appeals, that the mandatory nature of the sanction may be avoided only upon a finding by the district judge that the offending conduct was substantially justified or that an award of fees would be unjust. *Neither the district court nor the court of appeals found that defense counsels' conduct was substantially justified or that an award of fees would be unjust.* Defense counsel did not argue in the district court that they qualified for any exception to Rule 37. They simply argued that their conduct was upstanding and that there was no basis for an award of fees. Accordingly, the district court did not and could not have held that defense counsels' conduct was substantially justified or that an award of sanctions would be unjust. Given that such argument was never presented to the district court, it is unreasonable to presume that the district court relied on such an unstated argument to vacate the award.

The district court found defense counsels' conduct to be "egregious and sanctionable," and gave no clue that it found the conduct to be substantially justified or an award of fees to be unjust. The district court, without making any findings, simply responded to Mr. Karp's pleas for compassion, and vacated the award. Pursuant to Federal Rule 37, such is insufficient, and this Court should hear this case or remand per curiam to assure that the district courts find the prerequisites required by Rule 37 before relieving a party from sanctions.

II. DEFENSE COUNSELS' CLAIMS OF LACK OF NOTICE RING HOLLOW IN LIGHT OF THE EXTENSIVE RECORD IN WHICH THE DISTRICT COURT LITERALLY BEGGED DEFENSE COUNSEL TO DEFEND THEMSELVES AND OFFER SOME BASIS ON WHICH HE COULD DECLINE TO AWARD SANCTIONS.

Defense counsel had sufficient notice of the claims against them, and their claims to the contrary are contrived to support the unsupported suggestions of the court of appeals.

On April 26, 1991, **nearly one year before the district court entered its award of sanctions against defense counsel,** GES filed a motion to compel which sought an award of attorney fees against defense counsel. Defense counsel were well aware of this because the basis for their extension of time to respond to the motion was the fact that the request for fees against defendants and defense counsel created a potential for conflict of interest. On May 1, 1991, defense counsel requested additional time to respond to Plaintiff's Motion for Sanctions "to clarify whether and to what extent conflicts may be raised by the nature of the motion to compel." (Record Entry 118). Likewise, in plaintiff's motion for sanctions filed on August 27, 1991, GES specifically argued for an award of fees against defense counsel. Accordingly, defense counsels' claim that they were not on notice is controverted by the record.

In addition to the correction filed by Mr. Karp in regard to his argument of lack of notice in the district court, the record of the November 26, 1992 hearing reflects multiple opportunities for defense counsel to defend themselves. Judge Battisti specifically requested "whether there is a need to determine whether the defendants' non-compliance was defendants' fault or his counsel's fault." (Tr. at 3). The court inquired, "[i]s it defendants, or defendants' counsel, or does it make a difference?" (*Id.* at 22). The court pressed further: "I need to know, I need to be able to somehow be able to

determine whether defendants' non-compliance was it defendants' fault, or whether it was counsel's fault." (*Id.* at 50). Counsel ignored the court's pleas.

Further, when defense counsel sought later to claim that they had not received a fair hearing, the district court cited his inquiries at the hearing and defense counsels' own recognition of a conflict. The court rejected defense counsels' request for a new hearing on April 7, 1992, holding that defense counsel had an opportunity to present evidence at the November 26 hearing and chose "[f]or whatever tactical reason" not to present a defense. (Record Entry 240 at 2-3). In addition, defense counsel made no effort to make any additional defense of themselves during the four months between the November 1991 hearing and March 10, 1992 when the district court entered his order of sanctions. Accordingly, defense counsel were given more than sufficient opportunity to defend themselves, and may not attack the district court's unretracted findings that their conduct was "egregious and sanctionable."

III. IT WAS NOT AN -ALTERNATIVE BASIS FOR AFFIRMANCE THAT THE DISTRICT COURT DID NOT TRACE THE SANCTIONS TO SPECIFIC VIOLATIONS OF RULE 37, SINCE SUCH RIGIDITY WAS SPECIFICALLY REJECTED BY THIS COURT IN CHAMBERS.

As GES established in its Petition at 23, this Court held in *Chambers* that when conduct is punishable under both the court's inherent power and under the provisions of a rule of civil procedure, an award of sanctions need not be tied to violation of a specific procedural rule or "broken down into its component parts." *Chambers,* 115 L.Ed.2d at 55 (Scalia, Justice, dissenting). Requiring a court to first apply the procedural rules "would serve only to foster extensive and needless satellite litigation. . . . " *Id.* at 49.

Further, even if the legal principle espoused by defense counsel were applicable, no basis existed for vacating the award of sanctions against defense counsel and the district

court found no such basis. Rule 37(b)(2)(C) provides for an award against the "party failing to obey the order or the attorney advising that party or both." There is no question that defendants disobeyed several court orders and defense counsel rose to their defense. The Court of Appeals did not find to the contrary. Accordingly, the prerequisites for an award of sanctions against counsel are met.

Defense counsel now also challenge the manner in which the district court calculated the fees to be awarded against defense counsel. Pursuant to *Chambers*, the district court assessed against defense counsel all attorney fees associated with the litigation. Likewise, under Rule 37, the district court concluded that the conduct of defense counsel rendered the case untriable, and that therefore, the entire costs of the litigation was a result of discovery failures or misconduct. Accordingly, the district court properly found that a monetary sanction against defense counsel should include attorney fees for the entire litigation.

CONCLUSION

For the reasons set forth above and in petitioner's original petition, the petition should be granted and this Court should permit full briefing of the issues to determine whether the discovery rules and sanctions for their violation mean what they say or whether they are subject to the unbridled ad hoc standards of the luck of the random judicial draw. Due process, notice and fairness ought not to depend on chance but can only be assured by enforcing the standards previously set to govern the conduct of officers of the court.

Respectfully submitted,

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